84-1699

No.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

PUBLIC SERVICE COMPANY OF INDIANA, INC.,
Petitioner

v.

INTERSTATE COMMERCE COMMISSION and
UNITED STATES OF AMERICA,
Respondents

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 82-2399

PUBLIC SERVICE COMPANY OF INDIANA, INC., PEABODY COAL COMPANY,
Petitioners

v.

INTERSTATE COMMERCE COMMISSION and UNITED STATES OF AMERICA,
Respondents

LOUISVILLE & NASHVILLE RAILROAD COMPANY, ASSOCIATION OF AMERICAN RAILROADS, NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS,
Intervenors

No. 83-1691

PUBLIC SERVICE COMPANY OF INDIANA, INC., PEABODY COAL COMPANY,
Petitioners

v.

INTERSTATE COMMERCE COMMISSION and UNITED STATES OF AMERICA,
Respondents

NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS, ASSOCIATION OF AMERICAN RAILROADS, SEABOARD SYSTEM RAILROAD, INC.,
Intervenors

Petitions for Review of an Order of the Interstate Commerce Commission

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Argued March 28, 1984

Decided November 23, 1984

J. Raymond Clark, with whom *Mary Todd Foldes* and *C. Michael Loftus* were on the brief for petitioners.

Charles D. Gray, with whom *Paul Rodgers* and *Genevieve Morelli* were on the brief for intervenor NARUC. *Deborah A. Dupont* also entered an appearance for NARUC in No. 82-2399.

Edward O'Meara, Attorney, Interstate Commerce Commission, with whom *John Broadley*, General Counsel, and *Lawrence H. Richmond*, Deputy Associate General Counsel, Interstate Commerce Commission, *John J. Powers, III* and *John P. Fonte*, Attorneys, United States Department of Justice, were on the brief for respondents.

Rutherford Lyle Key, Jr., for intervenors Seaboard System Railroad, Inc. *Charles M. Rosenberger* also entered an appearance for Seaboard System Railroad, Inc. in No. 83-1691.

Stephen Ailes, Betty Jo Christian and *Samuel M. Sipe, Jr.* were on the brief for intervenor Association of American Railroads.

Before: GINSBURG, *Circuit Judge*; MACKINNON, *Senior Circuit Judge*; and HAROLD H. GREENE*, *District Judge.*

Opinion for the Court filed by *Senior Circuit Judge* MACKINNON.

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* Of the United States District Court for the District of Columbia, sitting by designation pursuant to Title 28 U.S.C. § 292(a).

MACKINNON, *Senior Circuit Judge*: This case involves a challenge under the Staggers Act to an order of the Interstate Commerce Commission ("ICC") that vacated a rate authorized by the Public Service Commission of Indiana ("Indiana Commission") for the intrastate rail carriage of coal, and reinstated the railroad's prior existing rate. Petitioners challenge the ICC's authority to set the rate aside. The ICC's opinion demonstrates that the Indiana rate was unlawfully set under the Staggers Act. Our nation's railroads have been subjected to intense Government regulation since 1887. The Staggers Act, enacted in 1980, sought to alleviate the tremendous financial problems plaguing the railroad industry. The enormity of the problem was indicated by Congress' finding, *inter alia*, that—

> (6) earnings of the railroad industry are the lowest of any transportation mode and are insufficient to generate funds for necessary capital improvement;
>
> (7) By 1985, there will be a capital shortfall within the railroad industry of between $16 [billion] and $20 [billion] . . .

Pub. L. No. 96-448, § 2, 96th Cong., 2d Sess., 94 Stat. 1896 (Oct. 14, 1980). Because we find that the ICC properly exercised its authority, we affirm.

I. BACKGROUND

Public Service Company of Indiana (the Utility) operates a bituminous coal-fired electric generating station at Cayuga, Indiana. Virtually all of the coal used in the plant is supplied by the Peabody Coal Company (Peabody) Universal Mine at Clinton, Indiana, which is 26.4 miles south of the Utility's generating station. The coal, about 2.5 million tons annually, is carried between the mine and the generating plant by the Louisville & Nashville Railroad (L&N),[1] using cars owned by the Utility.

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[1] The L&N no longer has a separate corporate existence. It is now part of the Seaboard System Railroad, Inc. (Seaboard). Seaboard is an intervening party in this case.

The route lies entirely within the state of Indiana. The Indiana Commission has initial jurisdiction under the Staggers Act over such intrastate rates.[2]

A. *The Indiana Commission Proceedings*

Before this case was initiated the Indiana Commission had, on September 12, 1980, upheld as reasonable the existing rate of $.69 per net ton for carriage of coal between the two points. By 1981, further increases raised L&N's rate to $.94/ton (Joint Appendix (JA) 140).[3] On March 27, 1981, the Utility and Peabody challenged the rate in an action before the Indiana Commission; a year and a half later, the complainants prevailed.[4]

At the hearing before the state commission, petitioners offered evidence that the L&N's variable cost of service in carrying the coal was $.39.1/ton. The L&N countered, claiming that its variable cost was $.46.6/ton. Calling

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[2] The Indiana Commission is a three-member body; each Commissioner is appointed by the Governor for a four-year term. Two of the three must be lawyers, and no more than two can be members of the same political party. Ind. Stat. Ann. § 8-1-1-2 (Burns 1973).

[3] The actual rate structure is very complicated, because various parts of the rate were subject to litigation in the Seventh Circuit, and some increases were not being collected because of that litigation (JA 140). Some increases had been instituted and abandoned, pending the outcome of litigation. The total rate, assuming the L&N prevailed in the other litigation, would have been $1.03/ton. The $.94/ton figure, however, is the actual rate in effect at the time of this case, and constitutes the rate determined and authorized by the ICC in this case. The other litigation appears irrelevant to this case.

[4] Complaint Against and Request for Reduction in the Intrastate Freight Local Unit Train Tariff on Bituminous Coal, Carloads from Clinton to Cayuga, Indiana, as Presently Set Forth in Louisville & Nashville Railroad Company Freight Tariff L&N 4278 and Supplements Thereto: Order Determining Threshold Jurisdiction Market Dominance and Rate Reasonableness, Clause No. 36431 (Public Service Commission of Indiana) (Sept. 17, 1982) (hereinafter "Indiana Decision") (JA 135).

the L&N's figures inaccurate, the Indiana Commission adopted the petitioners' $.39.1 figure. Indiana Decision at 16 (JA 150). The Indiana Commission determined that the *full* cost of service was $.55.8/ton, and that under ICC standards the "fully allocated costs of the subject movement are now 59 cents per net ton;" these costs, according to the Indiana Commission, *included* a pre-tax return on investment of 25.8%. *Id.* The Indiana Commission then acknowledged that the L&N was a revenue *inadequate* railroad, and that the L&N was thus entitled to use differential pricing—*i.e.*, to charge rates above fully allocated costs to captive customers such as the Utility and Peabody. In the pivotal aspect of its decision, however, the Indiana Commission further held that the L&N could adopt differential pricing *only if* its management was "honest, efficient, and economical."[5] Indiana Decision at 19 (JA 153).

In support of the "inefficiency" contention, the Indiana Commission placed substantial reliance upon L&N's pricing practices. The Commission also observed that the L&N did not rely on sophisticated marketing tools in setting its rates; that the profit margin of the L&N was lower than that of the CSX Corporation (CSX),[6] its parent corporation, and lower than that of the Southern Railway System (Southern), a competitor; and that inefficient management *could* be a cause of those discrepancies. Expert testimony also made several efficiency comparisons with Southern, and stated that the L&N was less efficient than Southern. The Indiana Commission found that a *prima facie* case of inefficiency had been established, and placed the burden of rebutting it upon the L&N. Indiana Decision at 19 (JA 153). The L&N

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[5] *See* 49 U.S.C. § 10704(a)(2) (1982); *see also id.* § 10707a(e)(2)(B) (Long-Cannon amendment).

[6] The CSX Corporation is a holding company that also includes two other Class I railroads, the old Chesapeake and Ohio (Chessie) and Seaboard Railroad.

allegedly did not meet that burden: The Indiana Commission held that because of "inferior profit margin" (Ind. Comm. Order, ¶ 66) and inferior use of equipment, the L&N was inefficient. The Commission also found that the railroad merely guessed at the best rate to charge on competitive traffic, and then tried to make up the difference on captive traffic. *Id.* at 24 (JA 158). Because the L&N was thus "inefficient," the Indiana Commission held that the "just and reasonable rate" would be $.55.8/ton—the fully allocated *cost* of service. *Id.* The Indiana Commission, though, is forbidden by the Staggers Act from setting rates below a certain point; at the time of its decision it could not set a rate below 165% of variable cost. *See* 49 U.S.C. § 10709(d)(2) (1982).[7] Under that provision, which constitutes a juris-

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[7] 49 U.S.C. § 10709(d)(2) provides:

> In making a determination under this section, the Commission shall find that the rail carrier establishing the challenged rate does not have market dominance over the transportation to which the rate applies if such rail carrier proves that the rate charged results in a revenue-variable cost percentage for such transportation that is less than—
>
> (A) 160 percent during the period beginning on the effective date of the Staggers Rail Act of 1980 and ending September 30, 1981;
>
> (B) *165 percent during the period beginning October 1, 1981, and ending September 30, 1982*;
>
> (C) 170 percent during the period beginning October 1, 1982, and ending September 30, 1983;
>
> (D) 175 percent or the cost recovery percentage, whichever is less, during the period beginning October 1, 1983, and ending September 30, 1984; and
>
> (E) the cost recovery percentage, during each 12-month period beginning on or after October 1, 1984.
>
> For purposes of subparagraphs (D) and (E) of this paragraph, the cost recovery percentage shall in no event be less than a revenue-variable cost percentage of 170 percent or more

dictional threshold, the *minimum* rate that could be set was $.65/ton (*i.e.*, 1.65 x $.39.1). So in its Order, the Indiana Commission set the rate, based on their construction of the facts and the law, at the lowest possible rate of $.65/ton. Indiana Decision at 24-25 (JA 158-59).

B. *The ICC Decision*

The L&N promptly appealed the Indiana Decision to the ICC, which has jurisdiction to review intrastate rates under the Staggers Act. 49 U.S.C. § 11501(c); *see generally Utah Power & Light v. ICC*, No. 83-1276, slip op. (D.C. Cir. Oct. 30, 1984). The ICC found that the Indiana Commission had applied federal law incorrectly, and vacated the $.65 rate. *Petition of Louisville & Nashville Railroad Co. for Review of a Decision of the Public Service Commission of Indiana Pursuant to 49 U.S.C. 11501*, No. 38946, slip op. (I.C.C. Nov. 22, 1982) (hereinafter "ICC November Decision") (JA 69). In its decision the ICC determined that the L&N's existing $.94 rate was "appropriate," and authorized the railroad to continue that rate.

The Utility and Peabody promptly petitioned for review in this court and the National Association of Regulatory Utility Commission (NARUC) intervened; that proceeding is No. 82-2399. In addition, the Utility and Peabody *subsequently* moved the ICC to reopen its decision, and the L&N moved for clarification. The ICC reopened its proceedings, and moved this court to stay our consideration pending final administrative resolution of the matter; petitioners responded that they did not oppose a limited stay. On March 28, 1983, this court issued an order that, in effect, stayed our review and allowed

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than a revenue-variable cost percentage of 180 percent. (emphasis added.)

It is worth noting that the Indiana PSC decided to set the rate at the 165 percent threshold *just two weeks* before the threshold was to be increased to 170 percent. *Id.*

the ICC to conduct its reopened proceedings. *Public Service Co. of Indiana v. ICC*, No. 82-2399 (D.C. Cir. Mar. 28, 1983) (interim order). As a result, while No. 82-2399 was pending before us, but before oral argument, the ICC issued a second opinion in this case. *Petition of Louisville & Nashville Railroad Co. for Review of a Decision of the Public Service Commission of Indiana Pursuant to 49 U.S.C. 11501*, No. 38946, slip op. (I.C.C. June 17, 1983) (hereinafter "ICC June Decision") (JA 6). The ICC acknowledged that its first opinion was unclear, and therefore it offered a fuller explanation of its decision. Petitioners seek review of the second opinion in No. 83-1691, now consolidated with No. 82-2399 for our review. In attacking the decision of the ICC, petitioners defend the decision of the Indiana Commission as consistent with all applicable federal standards, contend that the ICC impermissibly substituted its judgment for the factual findings of the state Commission, and argue that the ICC unlawfully authorized the existing L&N rate.

II. The Propriety of ICC's Second Opinion

We must address a threshold procedural issue before turning to the merits of the case. Petitioners contend that the *second* opinion issued by the Commission should not be considered in this case, but that our review must be limited to the first opinion. We decline to so limit our review in this case. As we have already indicated, the ICC's second opinion was issued in response to petitioners' motion to reopen and to the L&N's motion for clarification. The second opinion reflects a change in Commission membership and participation—Commissioner Simmons, who dissented from the first opinion, left the Commission; Chairman Taylor, who did not take part in the first opinion, dissented in the second opinion. Moreover, the second opinion, adopted by the Commission on a 3-1 vote, shows that the issues were reconsidered by the full Commission.

Petitioners request that we ignore the Commission's second opinion is based on the theory that it is nothing more than an impermissible "*post hoc* rationalization unsupported in the original decision." Petitioners' December, 1983 Brief at 7. They claim reliance on two cases: *S.E.C. v. Chenery Corp.*, 318 U.S. 80 (1943), and *National Nutritional Foods Association v. Weinberger*, 512 F.2d 688 (2d Cir. 1975), *cert. denied*, 423 U.S. 827 (1976). Neither case, however, stands for the proposition that a reviewing court may not consider a *clarifying opinion*, on the grounds that such an enlargement of judicial perspective would allow the agency to evade its responsibility to accompany its exercise of discretion with reasoned analysis. The Supreme Court's analysis in *Chenery* was founded on the principle that when Congress delegates to an administrative agency the discretion to administer and interpret a statute in light of its expertise and the public interest, it is the *agency* that must carry out that mandate. 317 U.S. at 92-95. Thus the reviewing court may not step into the breach by adopting a position not offered by the agency itself acting in its statutory capacity. Insofar as is here relevant, *Chenery* holds only that an agency's decision must reflect the reasons for its action, and that subsequent rationalizations cannot be substituted on appeal for contemporaneous reasoned decisionmaking. *Id.*; *see Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168-69 (1962) (courts may not accept appellate counsel's *ex post facto* arguments as a substitute for exercise of discretion by the agency itself). Similarly, *National Nutritional Foods* requires that an agency "adequately . . . explain its actions," but specifically permits the court to seek and to consider further explanation. 512 F.2d at 701.

The agency in this case offered further explanation without judicial prompting. For that the ICC cannot be faulted. In addition, it must be recognized that petition-

ers *specifically requested* reopening of the ICC's decision. The ICC reopened, reconsidered, reviewed the record, and issued a new opinion, authorized by a majority of the acting Commissioners. Petitioners observe correctly that if the lawyer's brief for the ICC had simply announced its clarifying analysis in the form of allegations or new explanations, such would constitute pure post-hoc rationalization not entitled to any consideration by this court. The clarifying opinion of the Commission, however, differs sharply from after-the-fact rationalizations made by attorneys or by courts. Here, we are presented with the authorized explanations considered, adopted, and issued by a majority of the Commission panel, in the legitimate exercise of its statutory responsibility and discretion.

Concerning the impact of the second decision on our reviewing role, the procedure used by the ICC in this case was implicitly approved by the Supreme Court in *American Farm Lines v. Black Ball Freight Service*, 397 U.S. 532 (1970). There the Court held that the ICC had power to reopen decisions and "add to the findings or firm them as the Commission deems desirable, *absent any collision* or *interference*" with the court. *Id.* at 541 (emphasis added). Dual jurisdiction in this circumstance is not irregular. A petition for judicial review does not terminate the ICC's authority over a matter, though any subsequent administrative action must be consistent with the court's exercise of its jurisdiction. *Id.* at 541-42. In this case, as in *American Farm Lines*, there can be no argument that the ICC's second decision exceeded the authority delegated to it by Congress or interfered with this Court's jurisdiction. It is significant that we took cognizance of the ICC's decision to reopen, and deferred our review accordingly. Moreover, the Commission's improved decision undoubtedly facilitates this court's review by clarifying the issues involved. In terms of judicial economy, it would be a waste of time to review only the first opinion when the efforts of the parties and particu-

larly the ICC have produced a better considered clarifying decision. We hold that the *second*, more closely considered decision is the agency action that should be the focus of our review.

III. Statutory Background to the ICC Decision

A. *ICC Authority Over Decisions of State Commissions*

The Staggers Act specifically reserved to the state jurisdiction over intrastate rail rates, but with significant specific limitations:

> A State authority may only exercise jurisdiction over intrastate transportation provided by a rail carrier providing transportation subject to the jurisdiction of the Commission . . . *if such State authority exercises such jurisdiction exclusively in accordance with the provisions of this subtitle.*

49 U.S.C. § 11501(b)(1) (emphasis added). The ICC must review the "standards and procedures" used by the state commissions to ensure that they "are in accordance with the standards and procedures applicable to regulation of rail carriers by the [ICC]." *Id.* § 11501(b)(3)(A). State rail regulation thus must conform to the Interstate Commerce Act, as amended by the Staggers Act.

The ICC has a duty "to assure that *intrastate* regulatory jurisdiction is exercised in accordance with the [federal] standards." *Id.* § 10101a(9) (emphasis added). Accordingly, the ICC is required to review the standards and procedures of each state commission in order to determine whether they comply with federal law. *Id.* § 11501(b)(2), (3). Those states which do not comply will not receive ICC certification and may not regulate *intrastate* traffic. *Id.* § 11501(b)(4)(A). In addition, and more importantly for our purposes, even after the states are certified, their regulatory decisions may still be subjected to ICC review:

> Any rail carrier providing transportation subject to the jurisdiction of the [ICC] . . . may petition the Commission to review the decision of any State authority, in any administrative proceeding in which the lawfulness of an *intrastate rate*, classification, rule, or practice is determined, *on the grounds that the standards and procedures applied by the State were not in accordance with the provisions of this subtitle.* The Commission shall take final action on any such petition within 30 days after the date it is received. If the Commission determines that the standards and procedures were not in accordance with the provisions of this subtitle, its order shall determine and authorize the carrier to establish the appropriate rate, classification, rule, or practice.

Id. § 11501(c) (emphasis added). This continuing ICC supervision was necessary, in the eyes of Congress, given the prior history of the inadequacy of intrastate rates as set by state public service commissions, "to ensure that the price and service flexibility goals of the [Staggers] Act are not undermined by state regulation of rates, practices, etc., which are not in accordance with these [federal] goals." H. Conf. Rep. No. 96-1430, 96th Cong., 2d Sess. 106 (1980), *reprinted in* 1980 U.S. Code Cong. & Ad. News 4110, 4118; *see* H.R. Rep. No. 96-1035, 96th Cong., 2d Sess. 61 (1980) (*estimating $400 million shortfall in railroad revenues for 1977 alone*, due to disparity between interstate and intrastate rates). Congress intended to stop the evil of interstate traffic rates being forced to subsidize intrastate carriage. In this particular case the ICC's review revealed a situation which authorized it to set aside the order of a state commission since "the standards and procedures applied by the State were not in accordance with the provisions of [the Staggers Act.]" 49 U.S.C. § 11501(c).

We recently held in *Utah Power & Light Co., supra*, at 27, after extensive analysis of the Staggers Act and

its legislative history, and in particular the text and background of section 11501(c), that the ICC has broad authority to review state commission rate decisions. The ICC's section 11501(c) jurisdiction is not of a limited appellate nature, but in a proper case is plenary, and may allow the ICC to delve into the factual record before the state agency. *Id.*

B. *The Staggers Act and its Balancing Approach in Ratemaking*

The Staggers Act specifically removes ICC and state jurisdiction over railroad rates applicable to *competitive* rail traffic. The ICC and the states, however, continue to exert jurisdiction over rates where a railroad "has market dominance over the transportation to which the rate applies." 49 U.S.C. § 10709(c). Under the Act, a rail carrier does not have market dominance with respect to a particular rate if the rate is less than 175% (165% at the time this case arose) of the railroad's variable cost. *Id.* § 10709(d)(2). Yet Congress specifically provided that a rail rate greater than 175% of variable costs does "*not* establish a presumption" either that the railroad is market dominant, or that the rate is unreasonable. *Id.* § 10709(d)(4) (emphasis added). Those issues must be determined on a case-by-case basis.

In ratemaking as well as generally, the present statutory system of national rail regulation is designed to accomplish a number of objectives:

> In regulating the railroad industry, it is the policy of the United States Government—
>
> . . .
>
> (3) to promote a safe and efficient rail transportation system by *allowing rail carriers to earn adequate revenues*, as determined by the Interstate Commerce Commission;[8]

---

[8] The problem addressed by Congress is currently reflected by the fact that the ICC determined that the composite railroad cost

(4) to ensure the development and continuation of a sound rail transportation system with *effective competition among rail carriers* and with other modes . . . ;

. . .

(6) *to maintain reasonable rates where there is an absence of effective competition* and where rail rates provide revenues which exceed the amount necessary to maintain the rail system and to attract capital;

. . .

(9) to cooperate with the States on transportation matters to assure that *intrastate regulatory jurisdiction is exercised in accordance with the standards established in this subtitle*; [and]

(10) to encourage honest and efficient management of railroads and, in particular, the elimination of noncompensatory rates for rail transportation . . . .

49 U.S.C. § 10101a (emphasis added). These policy pronouncements serve as an apt introduction to an act that requires the ICC to balance various factors in determining rail rates; they are just as applicable to interstate rates as they are when the ICC is required to review *intrastate* rates.

Among the primary concerns of the Congress that enacted the Staggers Act—and concerns recurrently addressed by the Act—was to ensure that railroads receive revenues adequate "to cover total operating expenses . . . for a *sound* transportation system . . ." (emphasis added) and to provide a reasonable return on their enormous

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of capital—1982 was 17.7 percent (ICC-Ex Parte No. 436, July 22, 1983) and that *every* Class I Railroad in America was *revenue inadequate* (ICC-Ex Parte No. 450, August 17, 1983). The Norfolk & Western had the highest return on investment—8.03 percent. *Id.*

capital investments. 49 U.S.C. § 10704. Given such focus, it is not surprising to find Congress explicitly providing that the importance of revenue adequacy *must* be stressed in ratemaking under the Act. In one important provision, Congress required:

> In determining whether a rate established by a rail carrier is reasonable . . . the commission *shall recognize the policy* of this [sub]title that rail carriers *shall earn adequate revenues*, as established by the Commission . . . .

Id. § 10701a(b)(3) (emphasis added). The Commission's responsibility to "allow rail carriers to earn adequate revenues," *id.* § 10101a(3), is elsewhere reinforced:

> The Commission shall maintain and revise as necessary standards and procedures for establishing revenue levels for rail carriers providing transportation subject to its jurisdiction under that subchapter that are adequate, under honest, economical, and efficient management, to cover total operating expenses, including depreciation and obsolescence, plus a reasonable and economic profit or return (or both) on capital employed in the business. *The Commission shall make an adequate and continuing effort to assist those carriers in attaining revenue levels prescribed under this paragraph.*

Id. § 10704(a)(2) (emphasis added); *see also* H.R. Rep. No. 96-1035, 96th Cong., 2d Sess. 54 (1980) (expressing a "clear directive to ensure financially sound railroads").

Revenue adequacy is not, of course, the only consideration in Staggers Act ratemaking. Indeed, concern that some captive shippers would be forced to shoulder an unfair burden in the provision of revenues to the railroads prompted Congress to include other efficiency related factors for mandatory consideration. For example, the Staggers Act provides:

(B) In determining whether to investigate or not to investigate any proposed rate increase . . . the Commission shall set forth its reasons therefor, giving due consideration to the following factors:

(i) the amount of traffic which is transported at revenues which do not contribute to going concern value and efforts made to minimize such traffic;

(ii) the amount of traffic which contributes only marginally to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize the revenues from such traffic; and

(iii) the impact of the proposed rate or rate increase on the attainment of the national energy goals and the rail transportation policy under section 10101a of this title, taking into account the railroads' role as a primary source of energy transportation and the need for a sound rail transportation system in accordance with the revenue adequacy goals of section 10704 of this title.

. . .

(C) In determining whether a rate is reasonable, the Commission shall consider, among other factors, evidence of the following:

(i) the amount of traffic which is transported at revenues which do not contribute to going concern value and efforts made to minimize such traffic;

(ii) the amount of traffic which contributes only marginally to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize the revenues from such traffic; and

(iii) the carrier's mix of rail traffic to determine whether one commodity is paying an un-

> reasonable share of the carrier's overall revenues.

49 U.S.C. § 10707a(e)(2)(B), (C) (Long-Cannon amendment); *see also id.* § 10704(a)(2) "honest, economical, and efficient management"). Even in including these so-called "Long-Cannon factors," however, Congress carefully avoided attaching any particular weights to the various concerns that must be taken into account. Nor did Congress attempt to prescribe the relative weights that state commissions should assign to these various factors in determining reasonableness: the overall scheme calls for a flexible, non-mechanical approach to ratemaking. Each factor must be given genuine consideration and some weight in setting both interstate and intrastate rates. By the same token, neither the ICC nor the state agencies can select any *one* factor as controlling.

The ICC has not issued, through any rulemaking proceeding, further specific guidelines as to rate reasonableness, although it has annually determined the revenue adequacy (or inadequacy) of the operating railroads.[9] The absence of any standard-setting by administrative rulemaking, however, does not leave a complete void. The *Staggers Act itself* sets certain standards that must be followed by the ICC and state commissions alike. *See Wheeling-Pittsburgh Steel Corp. v. ICC*, 723 F.2d 354-55 (3d Cir. 1983). Here, the ICC determined that the decision of the Indiana Commission did not comport with

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[9] The ICC's on-going proceeding, Ex Parte No. 347, Coal Rate Guidelines—Nationwide, has resulted in no uniform standard of reasonableness or across-the-board formula. Instead, the ICC in that proceeding has stated little more than that differential pricing is "an important tool in assisting the railroads toward revenue adequacy," and that "strict cost approach" is not a proper solution. Ex Parte No. 347, Coal Rate Guidelines—Nationwide (Sub. No. 1) 3, 8 (I.C.C. Dec. 21, 1981); *see also* Ex Parte No. 347, Coal Rate Guidelines—Nationwide (Sub. No. 1) (I.C.C. Feb. 24, 1983) (proposed guidelines).

certain standards directly established by the Staggers Act. It is that determination that we must review.

IV. The ICC's Review of the Indiana Decision

In *Utah Power & Light Co., supra,* at 27, we held that while our review of the ICC's section 11501(c) decisions is necessarily deferential, the Commission's authority under that provision to review state commission decisions is plenary. Under the Staggers Act, the ICC, when reviewing rate determinations made by state authorities, is authorized and indeed obligated to penetrate below the surface of the state opinion to the substance. A state commission should not be allowed to effectively shield its decision from review by merely articulating the proper federal standards, while improperly finding the facts, misapplying law to facts, or giving inordinate weight to isolated concerns. Lip-service is not enough. The applicable federal standards must be faithfully applied.

In our view, the approach of the Indiana Commission to this case falls well short of evenhanded, correct and faithful application of federal standards. The state's handling of the case is so one-sided as to appear to have been purely result-oriented—the desired result being the lowest possible rate. The state commission apparently decided to believe all of the shippers' cost evidence, and to disbelieve all of the railroad's cost evidence, and to end up arriving at the lowest possible cost figure. Next, the Indiana Commission acknowledged, as it was bound to do, that the ICC had determined the L&N to be revenue inadequate. The state went on, though, to hold that the authority of the L&N to utilize differential pricing was further contingent on its demonstrating its efficiency. Having diverted the case onto the solitary "efficiency track," the Indiana Commission then compared the L&N to the Southern which has a reputation as one of the nation's most efficient railroads, disbelieved all of the L&N's evidence, and ultimately found it to be "inefficient."

Finally, on that basis, the state commission reduced the existing rate to the jurisdictional threshold—the lowest level permitted by law.

In defense of the state commission's approach, petitioners argue that because the Indiana Commission announced that it was applying proper standards, and made detailed findings of fact, the ICC has no authority to set aside the Indiana rates. We reject this restricted view of the Commission's authority. Adoption of such principles would shield from review many, if not most, state rate decisions. As in this case, a state agency could accept all of the shippers' evidence and reject all of the railroad's evidence and then intrastate shippers could argue that determinations of the "finder of fact" cannot be reviewed. Or, as in this case, the state could compare any railroad to a "more efficient" competitor—only *one* railroad, after all, could ever be the *most* efficient—find the subject railroad to be inefficient, and set its rate at the jurisdictional threshold. We do not interpret the Staggers Act as allowing such shields to prevail. They are nothing more than transparent devices to evade the federal standards and procedures that Congress enacted in the Staggers Act to ensure that intrastate traffic would contribute a fairer share, in comparison with interstate and competitive traffic, of the revenue necessary to sustain a "sound" rail transportation system. Given the demonstrated historical propensity of state public service commissions to set intrastate rates at unreasonably low levels (Congress estimated a $400 million revenue shortfall in 1977 due to the gap between interstate and intrastate rates[10]), petitioner's construct would ef-

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[10] H.R. Rep. No. 96-1035; 96th Cong., 2d Sess. (May 16, 1980):

> This disparate treatment of intrastate and interstate traffic is reflected in the difference between the average revenue to variable cost ratios for each type of traffic: 1.20 for intrastate traffic and 1.36 for interstate traffic in 1977. If the intrastate ratio had been equal to the interstate ratio that year, the

fectively foil much of the congressional intent behind the Staggers Act. Accordingly, the ICC—like a court acting in a reviewing capacity—must have ample authority to carefully scrutinize the record to determine that the state agency has properly applied the law.

Scrutinizing the record in this case, the ICC found several basic flaws in the approach taken by the Indiana Commission: the state commission (1) held that the railroad was entitled to use differential pricing and to receive assistance in attaining revenue adequacy *only* if it was not "inefficient;" (2) transferred the burden of demonstrating efficiency to the railroad; (3) apparently used a mechanical test to hold that an inefficient railroad's rates should be set approximately at the jurisdictional threshold; (4) failed rationally to relate the rate reduction to the finding of inefficiency; and (5) relied on evidence insufficient as a matter of law to prove "inefficiency." We find that each of the ICC's reasons for reversing the Indiana Commission is entirely sound. The ICC and the federal courts must be allowed to protect against this kind of narrow, parochial protectionism, violative of both the letter and spirit of the Staggers Act. We consider in turn each violation of the federal statute.

A. *Conditioning Differential Pricing on Efficiency*

In its central error of law, the Indiana Commission held that the L&N was entitled to use differential pricing to attain revenue adequacy *only* if its management was demonstrably efficient:

> 54. Under Staggers the L&N is entitled to assistance in attaining revenue adequacy only 'under honest, economical and efficient management'.

Indiana Decision at 19 (JA 153). The ICC ruled that this was a fundamental misconstruction of the statute.

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railroads would have earned $400 million in additional revenues.

Id. at 61.

We agree. To be sure, the Staggers Act requires that railroad rates should be "adequate, under honest, economical, and efficient management, to cover total operating expenses, . . . including a reasonable and economic profit or return (or both) on capital employed in the business." 49 U.S.C. § 10704(a)(2). This is far from saying, however, that the right to use differential pricing and the goal of revenue adequacy are *entirely contingent* upon demonstrating "efficiency" to a state agency's satisfaction. One statutory factor cannot be isolated out of context, or blindly exalted at the expense of others that are at least co-equal in importance.

In contrast with the restricted view of the Indiana Commission, the ICC held that "carrier 'efficiency' [is] a factor that must be considered in determining the reasonableness of a challenged rate." ICC June Decision at 7 (JA 12). The Commission pointed to the Long-Cannon amendment to the Staggers Act, 49 U.S.C. § 10707a(e)(2)(C), *supra*, which helps to explain how efficiency evidence is to be used. Under that section the ICC must consider: (1) the amount of traffic that does not pay its way; (2) the attempts made to minimize such traffic; (3) the amount of low-profit traffic; and (4) the attempts made to increase profits on such traffic. The ICC then indicated the role that efficiency must play:

> The statute does not specify how these efficiency factors should be considered. It certainly does not mandate that a general showing of "inefficiency" bars any further rate increases or requires reduction of all existing rates to the jurisdictional threshold. Rather, by emphasizing the revenue adequacy policy, and making the efficiency factors "considerations" without specifying how they should affect the rate reasonableness issue, the statute leaves no doubt that the two considerations must be balanced together.

ICC June Decision at 7-8 (JA 12-13) (emphasis added). This ICC interpretation of the Staggers Act, a recent en-

actment, is entitled to substantial deference. Under Supreme Court precedent, it is well-established that a court should defer to "the interpretation given [a] statute by the officers or agency charged with its administration . . . [p]articularly . . . when the administrative practice at stake "involves *contemporaneous construction* of a statute by the men charged with a responsibility with setting its machinery in motion, of making the parts work efficiently and smoothly while they are yet *untried and new*." '" *Udall v. Tallman*, 380 U.S. 1, 16 (1965) (quoting *Power Reactor Development Co. v. International Union of Electrical, Radio & Machine Workers*, 367 U.S. 396, 408 (1961); quoting in turn *Norwegian Nitrogen Products Co. v. United States*, 288 U.S. 294, 315 (1933)) (emphasis added); *see Quern v. Mandley*, 436 U.S. 725, 744, n.5 (1978); *Fawcus Machine Co. v. United States*, 282 U.S. 375, 378 (1931) (citing cases); *cf. Martin v. Hunter's Lessee*, 14 U.S. (1 Wheat.) 304, 351-52 (1816) (approving legislative act as contemporaneous exposition of the Constitution, long continued).

In addition, as discussed *supra*, section III (B) of this opinion, the ICC's view that the Staggers Act requires a balance of factors in ratemaking is fully consistent with both the statutory language and legislative history. We adopt that interpretation. The whole thrust of ratemaking under the Act is *balancing*. By failing to balance efficiency against revenue adequacy—thereby, in effect, entirely eliminating consideration of the proper contribution to the attainment of revenue adequacy because of alleged inefficiency—the Indiana Commission misinterpreted the Staggers Act. That legal error pervades its entire opinion and alone justifies setting aside the rate determination of the Indiana Commission.

B. *The Burden of Proof*

The Indiana Commission next took the following step:

> 55. Although the burden of proving the assailed rate is unreasonable is upon [the Utility], once it

> has come forward with evidence showing that the management of L&N is not "honest, economical and efficient" the burden of rebutting such *allegation* in order to demonstrate entitlement to differential pricing above the Staggers mandate of 165% shifts to the L&N.

Indiana Decision at 19 (JA 153) (emphasis added). The Indiana Commission thereby basically held that if a shipper who is challenging a rate presents allegations that the state agency considers to be a *prima facie* case of inefficiency—*i.e.*, that the railroad is less efficient than *one* other railroad—the burden switches to the railroad "to demonstrate entitlement to differential pricing" above the Staggers Act jurisdictional threshold. *Id.*

The Indiana Commission offers no authority for this shifting of the burden of proof. Ordinarily, the shipper challenging a rate determination by the ICC based on market dominance has "the burden of proving that such rate is not reasonable . . ." The *shipper* here, not the railroad, must prove that the rate is *un*reasonable. 49 U.S.C. § 10701a(b)(2). There was no reason to deviate from or to ignore that rule, which constitutes a federal standard. While the Indiana Commission correctly quoted the Staggers Act standards, its conclusion that the burden of proof shifted to the L&N to prove the factors upon which the reasonableness of the rate rested renders its conclusion seriously defective. The state commission concluded: "the L&N has not presented convincing evidence that its management is efficient and economical." Indiana Decision at 23 (JA 157). This is completely backwards, and constitutes error justifying the invalidation of the rate determination. While the burden of proceeding might shift on a complete showing, the burden of proof under the statute is upon the party challenging the rate. 49 U.S.C. § 10701(b)(2)(A).

C. *The "Mechanical Test" of Setting the Rate at the Lowest Level*

The Indiana Commission also held that if a railroad is found to be inefficient, the carrier is not "entitle[d] to differential pricing above the Staggers mandate of 165%." Indiana Decision at 19 (JA 153). The ICC quite reasonably interprets this decision by the state commission as holding that the Staggers Act 165% jurisdictional threshold is presumptively the proper rate unless a railroad is found to be "efficient." Such construction by the Indiana Commission is erroneous. The Staggers Act clearly states to the contrary, that a rate at or above the jurisdiction threshold "does *not* establish a presumption that . . . the proposed rate exceeds or does not exceed a reasonable maximum." 49 U.S.C. § 10709 (d)(4) (emphasis added). This statutory provision explicitly rejects the drawing of any inference that the 165% rate was presumptively the *maximum* valid rate, or that rates over 165% have to be specially justified. In holding that, because the rate exceeded 165%, the L&N was required to prove its "efficiency," the Indiana Commission misinterpreted the Act. This "mechanical test," as the ICC characterizes it, is contrary to the rate flexibility required by Staggers.

D. *Absence of Rational Basis.*

The ICC points out that the approach of the Indiana Commission apparently was to rule that a railroad it found to be "inefficient" could not set any rate above the jurisdictional threshold. As the ICC notes, this construction is entirely arbitrary, and could well result in reducing a fair rate to a point far out of proportion to the alleged wrong. If, for example, the L&N loses $10 million a year through inefficiencies, it is contrary to the purposes of the Staggers Act, and to common sense, to force its rate down to a level where its income is reduced by $20 million. No national congressional purpose could

be served by cutting the revenues of an already revenue-inadequate railroad by an amount unrelated to the extent of the alleged inefficiency. In this case, the Indiana Commission never determined the amount of money that alleged inefficiencies cost the L&N; no evidence of dollar amounts appears to have been produced. It was, therefore, impossible for the ICC to tell, even if the state's theory was correct, whether the state's rate slashing was too much or too little. Such a crude approach falls well short of the reasoned decision making, in a balanced manner, required by the Staggers Act. The *balancing* aspect of the statute requires some attempt to tailor the remedy, rate reduction, to the goal, improving efficiency.[11] No such attempt was made here.

E. *Insufficiency of Evidence*

Finally, the ICC held that even if the Indiana Commission correctly construed the law, the evidence was insufficient to support a finding of "inefficiency." The evidence relied on by the Indiana Commission was as follows:

1. One witness, Professor Lerner, testified that L&N's profit margin of 6% was less than that of its parent company, CSX, which was 10%. He concluded that "the management of L&N is not as efficient as the management in other parts of the CSX." He stated, however, that "other reasons for differences in profit margin, for example *differences in operating characteristics*, might be responsible [for the discrepancy, but] . . . he had not attempted to determine reasons for such diferences." Indiana Decision at 19-20 (JA 153-54).

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[11] It is obvious that the Indiana Commission's approach could result in even *less* efficiency, since frequently an influx of additional cash may be necessary to pay for system improvements. Drying up revenues may not result in efficiency; it may only result in less efficiency, and eventually in bankruptcies.

2. Another witness compared the L&N to the Southern Railway, and found that the Southern was more efficient in "freight car, locomotive, labor, and track utilization." Indiana Decision at 19 (JA 153).

3. Testimony of L&N management indicating that the railroad L&N bases its pricing decisions on the expertise of its management, and does not rely on sophisticated marketing tools such as demand elasticity studies. Indiana Decision at 21, 24 (JA 155, 158). (Emphasis added.)

The Indiana Commission then, because the L&N relied solely on the expertise of its pricing officials, rejected its evidence of efficiency, and summarily dismissed L&N's efforts to improve efficiency as "commendable but . . . of limited scope." Indiana Decision at 22 (JA 156). The shippers' evidence in this case had some slight probative value on the issue of fact regarding efficiency. Petitioners contend, however, that the ICC was bound to leave undisturbed the fact-finding determinations of the Indiana Commission. As this court held in *Yellow Taxi Co. of Minneapolis v. N.L.R.B.*, 721 F.2d 366, 382-84 & n.37, 39 (D.C. Cir. 1983), however, even federal agencies are not free to manipulate their findings of facts as a means of avoiding judicial review of their ultimate conclusions. In addition, the rate-determination responsibility vested in the ICC by section 11501(c) of the Act, *supra*, and the legislative history of that section, make it clear that the ICC, in order to carry out Congress' scheme, has ample authority to examine facts to the degree necessary to assure that the state is treating interstate rail carriers fairly.

In this case, the Indiana Commission's factual handling of the efficiency question suggests manipulation. In particular, for instance, the state commission focused on a comparison of the L&N to the Southern Railway, which has a general reputation of being one of the nation's most

efficient and profitable railroads. *See* Petitioner's Brief at 28-29 (defending the comparison of the L&N to the Southern). If the Indiana Commission wants to inquire into efficiency, which it is certainly entitled to do, then it must do so on a more even-handed basis, in a manner that involves comparisons with a representative sampling of carriers during a relevant period of time (carriers having similar operating characteristics and profit potential) and that takes account of factors beyond the control of the railroad but potentially pertinent to its relative efficiency (*e.g.*, differences in grades, operating characteristics, competition and other relevant factors). This the state commission did not do.

The Indiana Commission based its conclusion that the L&N was "inefficient" largely on a comparison of its profits with those of CSX, its parent, and with those of the Southern Railway based on financial operating data for one year, 1980. The comparison to the remaining subsidiaries of CSX can be ignored because the complainants' evidence did not probe any operating differences that might justify differences in profit margins. *But see* discussion below. Differences in operating characteristics, which were not considered, could well cause a difference in profits.

This left the finding by the Indiana Commission of "inefficiency" resting principally upon the comparison of L&N's operating performance to that of its closest competitor, the Southern Railway System. The comparative data in this respect indicated that for the year 1980 the L&N had a return on investment of 5.5 percent and the Southern had a return on investment of 7.8 percent. 365 I.C.C. 285-88. Here again complainants made an inadequate attempt to support their contention by failing to determine whether the different results could be attributed to differences in operating characteristics or other justifiable factors. It is absurd to determine the "efficiency" of a railroad by comparing it to another railroad

without considering the differences, if any, between the two railroads' operating characteristics. And it is even more absurd to base such determination on a single year's operation. Railroad profits from year to year are highly volatile. They depend substantially upon the area the railroads serve, their operating conditions from year to year, financial conditions, their financial structure, the effect of the weather on crops, on operating conditions, the cost of fuel, the state of the local and national economy, the cost of disasters, and many other factors.

To illustrate the fatal defect of attempting to compare the rate of return of L&N to that of the Southern on the basis of the single year 1980, one need go no further than the financial data for the next two years. In 1981 the L&N *increased* its return to 7.04 percent while that of the Southern *dropped* slightly to 7.71 percent—a commendable showing by the L&N. 47 Fed. Reg. 52237-52238. But more importantly in 1982 the L&N bettered the Southern by earning 4.87 percent while the Southern's earnings fell to 4.36 percent. (ICC-Ex Parte No. 450 August 17, 1983). The Indiana Commission's highly selective comparison is self-evidently flawed.

The Indiana Commission's comparison of the L&N's 5.5 (6%) percent profit to the one year 10 percent profit of its parent CSX, however, is even more inapt. The CSX is *not* a railroad. It is a holding company—the parent of the Seaboard which absorbed the L&N by merger on December 29, 1982. Seaboard Brief at v. The Rule 8(c) certificate filed in this case by the Seaboard for itself and the L&N, both subsidiaries of CSX, indicates that the CSX is involved through subsidiary corporations in many other businesses other than railroads, including hotels and mineral and resources exploration and development. The listed affiliates of the L&N, through the parent CSX holding company, totalled 142 separate companies, Seaboard Brief at i-vi, and during this proceeding CSX acquired an additional 42 subsidiary com-

panies. *Id.* at v-vi. So it was clearly erroneous for the Indiana Commission to rule that the L&N was "inefficient" because its holding company parent had a profit of 10 percent in 1980 and the L&N had a profit of 5.5 percent. The two companies are not comparable.

But let us pursue the Indiana Commission's theory further. The Rule 8(c) certificate, *supra*, indicates that CSX is the holding company for four Class I *railroads* as subsidiaries. Let us compare the profits for the last three years of these four railroads in the CSX portfolio.

	ICC—Return on Investment			
	L&N	C&O (Chessie)	Seaboard	B&O [12]
1980 [13]	5.5%	6.8%	7.0%	3.8%
1981 [14]	7.04	5.38	2.10	2.37
1982 [15]	4.87	5.33	1.38	0.35
Average	5.80%	5.86%	3.49%	2.17%

This data shows the complete folly of resting a finding of "inefficiency" on such irrelevant evidence as the 10 percent return that CSX earned from its entire operation as a holding company. If we make a relevant comparison—to other Class I Railroads—we find the L&N's average return on investment for the past three years exceeds that of two of CSX's Class I Railroad subsidiaries and is within 6/100ths (.06%) percent of the C&O, the best performing Class I Railroad in the CSX portfolio. In fact, of the 42 Class I railroads included in the 1982 ICC Revenue Adequacy Report, the most recent, the L&N ranked a very creditable 9th.

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[12] The Baltimore & Ohio Railroad is also affiliated with the CSX Corporation. *See* Seaboard Brief, Rule 8(c) Certificate at i, ii.

[13] 365 I.C.C. 288.

[14] 47 Fed. Reg. 52238.

[15] ICC-Ex Parte No. 450, August 17, 1983.

Based on 1980 data a railroad was found to be revenue adequate under the standards of the Staggers Act if it had a return on investment of 12.1 percent or higher. 365 I.C.C. 286. For 1981 the Railroad Cost of Capital had risen to 16.5 percent. 47 Fed. Reg. 52236. In 1982 it was 17.7 percent. ICC-Ex Parte No. 436, July 22, 1983.

Recognizing all of the foregoing, it is obvious that substantial evidence does not support the ruling of the Indiana Commission that the L&N was "inefficient," or support the Commission's basic ruling that the burden of proceeding had shifted to the L&N to prove its efficiency. We agree with the ICC that complainants never satisfied the evidentiary requirements that would call for shifting the burden of proceeding to the L&N, much less placing upon the L&N the burden of proving that it was "efficient." Thus, on this record there was insufficient credible evidence for the agency to reasonably find the L&N to be "inefficient."

VI. The Federal Standards Established in the Staggers Act

Beyond their defense of the Indiana decision, petitioners' chief argument is that the Indiana Commission could not have violated a federal standard or procedure, within the meaning of section 11501(c), because the ICC has not adopted any national standard of revenue adequacy. This contention has a certain disingenuous appeal, but ultimately fails. It is true that the ICC has not promulgated, through any generic rulemaking, any national standard for maximum rail rates or overall revenue adequacy. The problem with the petitioners' argument, though, is that the ICC found that the approach of the Indiana Commission violated the provisions of the Staggers Act, *not* ICC revenue adequacy standards. The Act itself establishes federal standards that must be observed. *See Utah Power & Light Co., supra,* at 33; *Wheeling-*

Pittsburgh Steel Corp. v. ICC, 723 F.2d 346, 354-55 (3d Cir. 1983). This the complainants did not do.

Petitioners rely heavily on *Kentucky Utilities Co. v. I.C.C.*, 721 F.2d 537 (6th Cir. 1983), in which the ICC reversed the Kentucky Utilities Commission for using a rate method which, though consistent with the Staggers Act, differed from the formula *subsequently* approved by the ICC. The Sixth Circuit struck down the ICC's action: the ICC could not, according to the court, reverse a state commission for violating an ICC promulgated standard when it had not adopted any general standard. *Id.* at 544-45. There is a clear distinction, however, between *Kentucky Utilities* and this case. Here, the ICC has found the state decision to be in direct violation of the Staggers Act and the balancing approach that it entails. The ICC is challenging not the use or misuse of a particular rate formula, but rather the misinterpretation of the statute, the failure to balance faithfully and fairly the *statutory* factors. Thus, *Kentucky Utilities* simply has no application to this case. The rule sought to be applied by the petitioners would mean that the ICC would be entirely impotent to effectuate Congress' intent unless and until final revenue adequacy guidelines are adopted. Such a holding would immediately gut much of the Staggers Act. While modern regulatory practice has increasingly focused on the promulgation and enforcement of standards through rulemaking, it is well to remember that Congress itself can—and often does—establish federal standards. In the immediate context, the Staggers Act required the weighing of a number of statutory factors, and that some considerable weight be accorded to revenue adequacy. State proceedings that fail to heed these congressional pronouncements must be reversed by the ICC in the exercise of its section 11501(c) jurisdiction.

VII. Reinstatement of the L&N Rate

Having determined that the Indiana Commission's decision was inconsistent with federal standards, the ICC

was further obligated by the statute to "determine and authorize the carrier to establish the appropriate rate . . . ." 49 U.S.C. 11501(c). The Commission's rate-determination responsibility is distinct from its review of state proceedings, but both responsibilities must be discharged within the statutory thirty-day period for final action. As the Commission itself has recognized in this very proceeding, it "cannot remand the case to the state authority, but must establish an appropriate rate in the same decision . . . ." ICC June Decision at 20. In *Utah Power & Light Co., supra*, at 36, we accepted that interpretation of the Commission's authority.

In this case, the ICC determined that the "appropriate rate" was the existing rate of $.94/ton that had been set by L&N. In arriving at that determination, the Commission calculated a revised figure for variable costs, found the resulting ratio of revenue to variable costs to lie within the "reasonable" range established by applicable ICC precedents, and noted its concern for the railroad's revenue inadequacy. ICC November Decision at 6 (accompanied by appendix on costs) (JA 74, 77-79); ICC June Decision at 20-21 (JA 25-26). In its second opinion, the ICC added that the existing rate was "well below that of other intrastate and *interstate* unit-train coal rates in the area," the latter comparison being relevant due to the statutory policy of closing the gap between intrastate and interstate rates. ICC June Decision at 20 (JA 25). Finally, the ICC held that in the absence of a showing by complainants of unreasonableness, the carrier's rate would be allowed to stand; this was not a maximum reasonable rate, said the Commission, but only *a* reasonable rate that should not be lowered on the record in these proceedings. *Id.* at 21 (JA 26).

Petitioners challenge the ICC's rate determination, complaining that the Commission did not explain its decision to authorize the existing rate, and indeed allegedly ignored various statutory concerns in so doing. This argu-

ment appears to be a variant of petitioners' complaint, discussed *supra*, that the Commission has established no general standard of rate reasonableness. In addition, it should be emphasized that petitioners have launched a sweeping attack on the ICC's exercise of its authority, rather than pointing to any *specific* deficiencies in the cost findings or analysis of revenue-to-cost ratios. Before this court, petitioners have merely defended the finality of the Indiana Commission's fact finding concerning costs, without regard to the substance.

We must decide whether the Commission has adequately supported and justified its "appropriate rate" determination. In so doing, we are mindful that the ICC has been setting railroad rates for close to a century now, and that its accumulated expertise in such matters far exceeds that of any court. Our review in ratemaking cases is deferential. *See supra.* We are also aware that the Commission is presently working under a fairly fresh, and substantially reformed congressional mandate, in the form of the Staggers Act. [Congress did not define what it meant by the term "appropriate" as employed in section 11501(c). Moreover, the Commission has not yet interpreted the relationship of section 11501 (c) "appropriateness" to the "reasonableness" determinations elsewhere required by the Staggers Act.] *See Utah Power & Light Co. v. ICC, supra,* at 29. Nor need we do so in order to decide this case. We note only that the section 11501(c) mandate to "determine and authorize . . . the appropriate rate" does not call for the Commission to "prescribe" a rate within the meaning of *Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Railway,* 284 U.S. 370 (1932).

In the absence of any specific criticisms by petitioners of the ICC's cost findings, we cannot find inadequate the cost evidence supporting the Commission's rate determination. Nor were the figures and use of precedents for revenue to variable cost ratios inadequately reasoned or

presented. From its opinion and cost appendix, it appears that the Commission articulated and took into consideration relevant statutory factors. In the absence of any specific statutory guidance as to how an "appropriate rate" must be derived, we cannot require more from the Commission than the provision of substantial evidence, consistency with the statute, and reasoned decision-making. We are thus constrained to find that from its decision and opinions, the ICC's "path may reasonably be discerned." *Bowman Transportation, Inc. v. Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 286 (1974).

VIII. Conclusion

For the reasons herein before stated, we affirm the decisions of the ICC in 83-2399 and 83-1691 in their entirety.

Judgment accordingly.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT
SEPTEMBER TERM, 1984

No. 82-2399

PUBLIC SERVICE COMPANY OF INDIANA, INC.,
PEABODY COAL COMPANY,
Petitioners

v.

INTERSTATE COMMERCE COMMISSION and
UNITED STATES OF AMERICA,
Respondents

LOUISVILLE & NASHVILLE RAILROAD COMPANY,
ASSOCIATION OF AMERICAN RAILROADS,
NATIONAL ASSOCIATION OF
REGULATORY UTILITY COMMISSIONERS,
Intervenors

No. 83-1691

PUBLIC SERVICE COMPANY OF INDIANA, INC.,
PEABODY COAL COMPANY,
Petitioners

v.

INTERSTATE COMMERCE COMMISSION and
UNITED STATES OF AMERICA,
Respondents

NATIONAL ASSOCIATION OF
REGULATORY UTILITY COMMISSIONERS,
ASSOCIATION OF AMERICAN RAILROADS,
SEABOARD SYSTEM RAILROAD, INC.,
Intervenors

Petitions for Review of an Order of the Interstate Commerce Commission.

[Filed Nov. 23, 1984]

Before: GINSBURG, Circuit Judge; MACKINNON, Senior Circuit Judge; and HAROLD H. GREENE *, District Judge.

JUDGMENT

These causes came on to be heard on the petitions for review of an order of the Interstate Commerce Commission, and were argued by counsel. On consideration thereof, it is

ORDERED and ADJUDGED, by this Court, that the order of the Interstate Commerce Commission under review herein is hereby affirmed, in accordance with the Opinion for the Court filed herein this date.

Per Curiam

For the Court

/s/ George A. Fisher
GEORGE A. FISHER
Clerk

Date: November 23, 1984

Opinion for the Court filed by Senior Circuit Judge MacKinnon.

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* Of the United States District Court for the District of Columbia, sitting by designation pursuant to Title 28 U.S.C. § 292(a).

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT
SEPTEMBER TERM, 1984

No. 82-2399

PUBLIC SERVICE COMPANY OF INDIANA, INC.,
PEABODY COAL COMPANY,
Petitioners

v.

INTERSTATE COMMERCE COMMISSION and
UNITED STATES OF AMERICA,
Respondents

And Consolidated Case No. 83-1691

[Filed Jan. 29, 1985]

Before: ROBINSON, Chief Judge, WRIGHT, TAMM, WALD, MIKVA, EDWARDS, GINSBURG, BORK, SCALIA and STARR, Circuit Judges, MACKINNON, Senior Circuit Judge and HAROLD GREENE, District Judge, U.S. District Court for the District of Columbia

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ORDER

The Suggestions for Rehearing *en banc* of the Public Service Company of Indiana, Inc., et al. and the National Association of Regulatory Utility Commissioners have been circulated to the full court and no member has requested the taking of a vote thereon. Upon consideration of the foregoing it is

ORDERED, by the Court *en banc*, that the aforesaid Suggestions are denied.

Per Curiam

For the Court:

GEORGE A. FISHER,
Clerk

By: /s/ Robert A. Bonner
ROBERT A. BONNER
Chief Deputy Clerk

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT
SEPTEMBER TERM, 1984

No. 82-2399

PUBLIC SERVICE COMPANY OF INDIANA, INC.,
PEABODY COAL COMPANY,
Petitioners

v.

INTERSTATE COMMERCE COMMISSION and
UNITED STATES OF AMERICA,
Respondents

And Consolidated Case No. 83-1691

[Filed Jan. 29, 1985]

Before: GINSBURG, Circuit Judge, MACKINNON, Senior Circuit Judge and HAROLD GREENE, District Court Judge, U.S. District Court for the District of Columbia

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ORDER

Upon consideration of the Petitions for Rehearing of the Public Service Company of Indiana, Inc., et al and

the National Association of Regulatory Utility Commissioners, it is

ORDERED, by the Court, that the aforesaid Petitions are denied.

Per Curiam

For the Court:

GEORGE A. FISHER,
Clerk

By: /s/ Robert A. Bonner
ROBERT A. BONNER
Chief Deputy Clerk

APPENDIX E

[Service Date June 23, 1983]

INTERSTATE COMMERCE COMMISSION DECISION

No. 38946

PETITION OF LOUISVILLE AND NASHVILLE RAILROAD COMPANY FOR REVIEW OF A DECISION OF THE PUBLIC SERVICE COMMISSION OF INDIANA PURSUANT TO 49 U.S.C. 11501

Decided: June 17, 1983

Intrastate rate prescribed by state agency found not rationally based on the evidence and inconsistent with preemptive federal standards.

R. Lyle Key, Jr., for railroad petitioner.

J. Raymond Clark, Mary Todd Foldes, and *Greg K. Kimberlin* for public utility intervenor.

By the Commission:

By decision served March 23, 1983, we reopened this proceeding for reconsideration on the present record. Based on our further careful review, we conclude that while our prior decision did not adequately articulate our reasons for the result reached, the result itself was proper. Accordingly, in this decision we provide a fuller explanation of our action. We will repeat the relevant facts and background of this proceeding only as necessary to clarify our present discussion.

A. *Decision of the Public Service Commission of Indiana and Petition of Louisville and Nashville Railroad Company.*

On September 17, 1982, the Public Service Commission of Indiana issued an order finding the applicable intrastate coal rate of 94 cents per net ton published by Louisville and Nashville Railroad Company (L&N)[1] unreasonable. The state commission determined the reasonable rate to be not more than 65 cents per net ton upon its finding that L&N's variable cost for the subject traffic was 39.1 cents per net ton,[1a] Indiana set the rate at a level that exactly yields a revenue to variable cost ratio of 165 percent, the jurisdictional threshold at the time.[2]

Recognizing that the Interstate Commerce Act directs this Commission to make an "adequate and continuing effort" to assist carriers in attaining revenue adequacy,[3] 49 U.S.C. 10704(a)(2), and further recognizing both the

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[1] In January, 1983, L&N merged with its affiliate Seaboard Coast Line Railroad to form Seaboard System Railroad, Inc.

[1a] L&N argued that its variable cost for the traffic was 46.6 cents per net ton. L&N stipulated that it possessed market dominance over the traffic and that its published rate exceeded the jurisdictional threshold for regulatory purposes.

[2] The jurisdictional threshold rose to 170 percent on October 1, 1982. See 49 U.S.C. 10709(d)(2).

[3] Pursuant to 49 U.S.C. 10704(a)(4), we must annually determine which rail carriers are earning "adequate revenues" as that term is defined under standards and procedures adopted by us under Section 10704(a)(2). L&N has not achieved revenue adequacy. In 1980, L&N had a 5.5 percent return on investment, which was below the 12.1 percent return determined to be the appropriate level for revenue adequacy. Ex Parte No. 416, *Railroad Revenue Adequacy—1980 Determination*, 365 I.C.C. 285 (1981). In our latest revenue adequacy determination, we found that L&N's 1981 return on investment was 7.04 percent, below the 16.5 percent level for current cost of capital. Ex Parte No. 439, *Railroad Revenue Adequacy—1981 Determination*, —— I.C.C. —— (1982).

need for differential pricing and its favored use in rail pricing decisions (Indiana Findings Nos. 45-50), the state commission ostensibly undertook to examine the "reasonableness" of L&N's rate within the framework of those policies (Indiana Findings Nos. 51-71). Indiana stated, however, that although L&N is entitled to differential pricing, its entitlement to assistance in attaining revenue adequacy depends on the carrier's business being conducted "under honest, economical and efficient management" (Indiana Finding No. 54). See 49 U.S.C. 10704(a)(2). The state commission then held that, once complainants had come forward with evidence showing that the management of L&N is not "honest, economical and efficient," the burden of rebutting that showing shifted to the carrier seeking to use differential pricing to set its rate above the jurisdictional threshold (Indiana Finding No. 55). The state concluded that on this record L&N had been shown to be inefficiently managed, and that although the carrier was entitled to the benefit of some differential pricing because of its revenue inadequacy, it should not be permitted to price its service above the jurisdictional threshold.[4]

On October 25, 1982, pursuant to 49 U.S.C. 11501(c), L&N sought our review of Indiana's decision. L&N sought relief on the grounds that the decision was inconsistent with federal standards and procedures. The car-

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[4] In *Arkansas Power & Light Co.-Amendment-Staggers Act*, 365 I.C.C. 983 (1982) (*Long-Cannon*) *review pending sub nom. Arkansas Power & Light Company* v. *ICC*, Nos. 82-1484, 82-2219, and 82-2307 (D.C. Cir.), we recently described how carriers and shippers should introduce evidence in individual rate cases concerning the so-called "Long-Cannon" factors set forth at 49 U.S.C. 10707a(e)(2)(B) and (C) and the related "honest, economical, and efficient management" language in 49 U.S.C. 10704(a)(2).

In Ex Parte No. 347 (Sub-No. 1), *Coal Rate Guidelines, Nationwide* (not printed), served February 24, 1983, 48 Fed. Reg. 8362 (Feb. 28, 1983), we proposed standards governing differential pricing.

rier sought to have us revoke the provisional certification of Indiana (which allows the state to exercise jurisdiction over intrastate rail transportation), and to have us establish as appropriate a rate of 94 cents per ton at the October 1, 1981 level, subject to any later increases.

B. *Our Prior Decision.* By decision served November 24, 1982, we found that in holding down L&N's rate to the jurisdictional threshold based on its finding that L&N is inefficiently managed, Indiana had failed to apply standards and procedures consistent with federal law. In our discussion, we focused on Indiana's inappropriate reliance on L&N's failure to employ demand elasticity studies in pricing its traffic. We concluded that by relying on a questionable finding of inefficient carrier management to prescribe the rate at the lowest level jurisdictionally possible, Indiana had failed to give "genuine" consideration to revenue adequacy, and had thereby violated one of the most important federal standards. We overturned Indiana's prescription of a maximum reasonable rate of 65 cents per net ton, and reinstated L&N's applicable rate of 94 cents per net ton at the October 1, 1981 level, subject to later increases.[5]

C. *Petition to Reopen.* On December 14, 1982, the Public Service Company of Indiana, Inc. (PSI), a complainant in the state proceeding, petitioned us to reopen our prior decision for reconsideration.[6] L&N replied. PSI argues that in our prior decision we erred both in our

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[5] In a pleading filed December 1, 1982, L&N filed a Petition for Clarification requesting us to "authorize" the rate rather than "prescribe" the rate as we did in our prior decision. See discussion, *infra*.

[6] Immediately following issuance of our prior decision, PSI and Peabody Coal Company (the other complainant at the state level), filed a petition for review in the United States Court of Appeals for the District of Columbia Circuit. *Public Service Company of Indiana, Inc. et al.* v. *Interstate Commerce Commission and United States of America*, No. 82-2399.

substantive analysis of the state's action and in our analysis of the variable costs (upon which Indiana based its rate prescription, pegged to the jurisdictional threshold).

DISCUSSION AND CONCLUSIONS

We have carefully reviewed our prior decision, PSI's petition to reopen, L&N's reply, the record before the state commission and the applicable law in this area. We are persuaded that in our prior decision we correctly overturned the state agency's decision. Although we believe this case presents very difficult issues concerning an evolving area of regulation, we are convinced that by first finding L&N to be an "inefficiently" managed railroad, and then by reducing the railroad's published rate to a level that exactly meets the jurisdictional threshold (based on the inefficiency finding), the state commission reached a decision that was neither rationally based nor in accordance with federal standards.

We reopened this proceeding because we believed that our prior decision inadequately articulated our reasons for our conclusion. Specifically, our prior decision emphasized only one aspect of Indiana's determination of the degree to which L&N is "entitled" to the benefits of differential pricing on the involved traffic. Our decision cited the state commission's criticism of L&N's failure to employ quantifiable or sophisticated marketing tools such as demand elasticity studies (Prior decisions at 4-5). We concluded that the state's "reliance" upon failure to employ these tools in finding L&N to be inefficient "was improper in and of itself." *Id.* at 5. In its petition to reopen, PSCI argues, among other things, that the impression left by the cited language is that the state agency totally relied upon that single finding in determining that L&N is inefficient. Because we agreed that the statement regarding Indiana's "reliance" on that single factor was too broad, we reopened this proceeding for reconsideration.

Upon further analysis, we find, however, that the ultimate conclusions in the prior decision were correct. In the discussion that follows, we will discuss our reasons for so finding. Summarizing those reasons, we find that the state's decision violated the Act's requirement that regulation of rates assist railroads toward adequate revenues. The state's error is its mechanistic view that any railroad rate above the jurisdictional threshold is unreasonable if there has been a showing that the railroad's management is not "honest, economical, and efficient." The Interstate Commerce Act and our standards implementing the Act impose no such mechanical and absolute restraint on rates. To the contrary, the federal standards plainly require that a delicate balance be struck between the strong revenue adequacy policy and the need for efficiency. The state's mechanistic approach improperly subordinates revenue adequacy to efficiency, and thus violates the Act.

In addition, even if the state's decision were correct in its assumption as to revenue adequacy, we find that the centerpiece of that decision—the finding that L&N is "inefficient"—itself reflects standards in direct conflict with federal standards, and is unsupported by the record. Specifically, federal standards as we have interpreted them mandate that claims of inefficiency be more particularized if they are to influence the reasonableness determination, and specifically state that the failure to conduct demand elasticity studies does not constitute "inefficiency." Moreover, as a factual matter, the evidence cannot support an inefficiency finding. Thus, the general evidence presented in this case cannot and does not establish inefficiency under federal standards.

Finally, we also find that the state's decision ignored the requirement of federal standards and procedures that there be a reasonable relationship between the wrong (the railroad's alleged inefficiency) and the remedy (the rate reduction).

I. *The Federal Standards*

A. *Railroad Revenue Adequacy*

Congress has made achievement of railroad revenue adequacy a crucial factor in individual rate cases. See 49 U.S.C. 10701a(b)(3) and 10704(a)(2); Ex Parte No. 393, *Standard for determining Railroad Revenue Adequacy*, 364 I.C.C. 802 (1981), *aff'd sub nom. Bessemer & Lake Erie R.R. Co.* v. *ICC*, 691 F.2d 1104, 1108 (3rd Cir. 1982) (cert. denied, No. 82-1369, June 6, 1983), and we have determined that differential pricing is necessary if railroads are to achieve the Congressionally-mandated goal of revenue adequacy. See Ex Parte No. 347 (Sub-No. 1), *Coal Rate Guidelines, Nationwide* (not printed), served February 24, 1983, 48 *Fed. Reg.* 8362 (Feb. 28, 1983), pages 7-8. Under differential (or demand-based) pricing, a railroad may charge shippers in competitive markets a rate returning less profit than a rate charged to shippers in captive markets.[7]

The legislative history of the Staggers Rail Act of 1980 demonstrates just how important Congress believed railroad revenue adequacy is in any individual rate case. For the period 1969 to 1979, the combination of low earnings and a significant increase in the cost of capital resulted in an average rate of return on investment in transportation for Class I railroads of less than three percent per year. H.R. Rep. No. 1035, 96th Cong., 2d Sess. 101 (1980) (*House Report*). Inadequate railroad revenues began to take a toll on the industry's physical plant. S. Rep. No. 470, 96th Cong., 1st Sess. 3 (1979) (*Senate Report*). Faced with the prospect of dwindling revenues and deteriorating physical plant, Congress attempted a legislative solution in 1976 by passing the

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[7] Differential pricing reflects the varying demand for a carrier's service. The Commission and courts have often affirmed the role of differential pricing in railroad ratemaking. See, *e.g.*, *San Antonio, Texas* v. *United States*, 631 F.2d 831, 851-852 (D.C. Cir. 1980).

4R Act.[8] Because the root of so many railroad problems appeared to be the inability of carriers to generate enough revenue to maintain the needed quality of service, a prime intention of the 4R Act was to limit the Subcommission's regulation over ratemaking.[9] The rationale for this jurisdictional limit was the "strong Congressional conviction" that, when a railroad was forced to compete for traffic with other modes of transportation (or another railroad), competitive forces would result in the setting of rates at reasonable levels, with no need for regulatory control. *See Potomac Electric Power Co.* v. *United States*, 584 F.2d 1058, 1067 (D.C. 1978).

Congress was soon forced to conclude, however, that the 4R Act "has not provided the flexibility in rates that the industry needs to earn revenue sufficient to maintain and improve the rail system." *House Report* at 38. The financial problems of the industry had worsened to the point that Congress determined that the "failure to achieve increased earnings within the railroad industry will result in either further deterioration of the rail system or the necessity for additional Federal subsidy." Congressional Declaration of Findings, Pub. L. No. 96-448, § 2(8), 94 Stat. 1895, 1896 (1980).

The purpose of the Staggers Act was:

> to provide for the restoration, maintenance and improvement of the physical facilities and financial stability of the rail system of the United States.

Pub. L. 96-448, § 3; 94 Stat. 1895, 1897 (1980). Congress recognized that this goal could be achieved only by placing "primary emphasis on the adequacy of railroad

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[8] Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. No. 94-210, 90 Stat. 31 (1976).

[9] The House Committee on Interstate and Foreign Commerce reported that "the significant reason for the decline in railroads' business has been the inflexibility of existing regulation." *House Report* at 38.

revenues and the financial needs of the industry." 126 Cong. Rec. H5901 (daily ed. June 30, 19800) (remarks of Rep. Madigan).

The principal mechanism adopted by Congress to promote the revenue adequacy goal was allowing rail carriers greater flexibility to set their own rates and to restrict drastically the Commission's jurisdiction to regulate rates. To prevent this Commission from continuing to assert jurisdiction over rates that Congress wished to deregulate, the Staggers Act explicitly deprived the Commission of jurisdiction over the reasonableness of any rate below a specified revenue-to-variable cost percentage (the jurisdictional threshold). 49 U.S.C. 10709(d)(2). And, to make it clear that a rate cannot be regarded as unreasonable simply because it is above the threshold, Congress further provided that such a fact "does not establish a presumption" that a rate "does or does not exceed a reasonable maximum." 49 U.S.C. 10709(d)(4).

Most significantly for the purposes of this proceeding, Section 201(a) of the Staggers Act provided that, even in those cases where we retain jurisdiction over rail rates, we must "recognize the policy of this title that rail carriers shall earn adequate revenues" in determining whether a challenged rate is reasonable. 49 U.S.C. 10701a (b)(3). The House committee that drafted Section 201 (a) explained its purpose (*House Report* at 54) (emphasis added):

> This provision sets forth for the first time a standard for the Commission to use in determining if a rate is reasonable, and that standard goes to assuring that railroads can continue to operate as private enterprises. The bill requires the Commission to recognize the policy that efficient rail carriers shall earn adequate revenues. Previous admonitions by the Congress that the Commission assist carriers in earning adequate revenue levels (49 U.S.C. 10704) have not

> achieved their goals. As a result, *the Committee is establishing a more straight forward mandate. This is a clear directive to ensure financially sound railroads, and the Commission is not to misuse the term "reasonable" to circumvent this directtive.*

Thus, the revenue adequacy mandate of the Staggers Act could not have been more emphatic.

The railroads' right to adequate revenues is not entirely unrestrained, because the statute explicitly makes carrier "efficiency" a factor that must be considered in determining the reasonableness of a challenged rate. Thus, Section 10704(a)(2) requires the Commission to ensure that railroads earn adequate revenues "under honest, economical, and efficient management," and Section 10707a(e)(2)(C) directs the Commission in a rate reasonableness proceeding to consider, among other factors, evidence of: (1) the amount of the carrier's traffic which fails to contribute to going concern value or contributes only marginally to fixed costs; (2) the carrier's efforts to minimize such traffic and the extent to which rates on such traffic can be raised; and (3) the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues.[10]

The statute does not specify how these efficiency factors should be considered. It certainly does not mandate that a general showing of "inefficiency" bars any further rate increases or requires reduction of all existing rates to the jurisdictional threshold. Rather, by emphasizing the revenue adequacy policy, and making the efficiency factors "considerations" without specifying how they should affect the rate reasonableness issue, the statute leaves no doubt that the two considerations must be balanced together. Thus, we have established that the statutory provisions bearing on the issue of management efficiency were not intended to thwart the other goals of the Act,

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[10] These three factors are the so-called "Long-Cannon factors."

most notably the very important goal of railroad revenue adequacy, or to be the basis for an entire regulatory scheme. *Long-Cannon, supra*, 365 I.C.C. at 988.[11] Indeed, Senator Long, one of the co-sponsors of the amendment that put the Long-Cannon factors into the statute, indicated that his principal concern in proposing the amendment was with the power of *revenue adequate* railroads to extract an unfair profit from captive shippers (emphasis added):

> The question I have maintained throughout examination of this legislative proposal has been whether *railroads that have already achieved revenue adequacy* should be free to extract monopoly profits without proper justification, without Interstate Commerce Commission scrutiny and without attempts to maximize the revenues from noncaptive traffic.[12]

We have elaborated on that basic theme in Ex Parte No. 347 (Sub-No. 1), where we said (Feb. 24, 1983 decision, at 14, n. 40) that a rate might be found unreasonable through application of the efficiency factors if it were shown, for example, for example, that a railroad had rates below going concern value and the railroad could achieve revenue adequacy if it were to raise such rates.

In short, the federal standard for applying the efficiency factors is, and has been since enactment of those factors, to consider and balance the factors in such a way that railroads can work toward revenue adequacy and efficiency at the same time. Neither the statute nor our decisions have been hinted that the necessary balancing can be achieved by simple formulae or general allegations. Rather, the statute inevitably requires, as we have repeatedly stated, that there be a balancing and that it be

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[11] *Long-Cannon* was issued two weeks before the state agency issued its decision.

[12] 126th Cong. Rec. 14003 (daily ed., September 30, 1980), quoted in *Long-Cannon, supra*, 365 I.C.C. at 988.

focused and based on specific evidence. See *Long-Cannon, supra.*

B. *Railroad Efficiency*

In our *Long-Cannon* decision,[13] we established federal standards for considering the Long-Cannon and efficiency factors in rail rate cases. Under those standards, the party with the burden of proof in the Commission proceeding has the burden of producing relevant Long-Cannon evidence. Thus, in a complaint case, as here, the complainant must produce the relevant evidence. 65 I.C.C. at 997, 999. Only if the complainant produces relevant evidence need the railroad try to rebut it with its own evidence. *Id.* at 997. We emphasized that the Long-Cannon evidence of a complainant must be specific by identifying particular commodities or rates or routes that it believes appropriate for Long-Cannon analysis. *Id.* Accordingly, while we said we would honor reasonable requests to discover specific information from railroads, we also stressed that we would not sanction fishing expeditions for cost studies for all of a carrier's movements such as were sought here. In that vein, we specifically rejected the suggestion that demand elasticity studies are a necessary basis for optimal railroads pricing. *Id.* at 992. Instead, we stated that a carrier's marketing efforts, conducted through negotiations with shippers, and based on its rate officers' knowledge of the presence and level of competition, are generally adequate for constructing an optimal price structure. *Id.*

In short, the federal standard for showing a railroad inefficient requires a specific showing grounded in facts. Sweeping general allegations of system-wide inefficiency were rejected, and indeed neither the statute nor any of our pronouncements hints that carriers can or should be labeled "efficient" or "inefficient" system-wide. Rather,

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[13] See footnote 4, *supra.*

federal standards in effect when the state issued its decision (and still in effect now), require a far more precise showing of "inefficiency," to product a downward adjustment in an otherwise reasonable rate.

C. *Relationship Between The Wrong And The Remedy*

In addition to its requirements pertaining to revenue adequacy, the Act requires a reasonable relationship between the wrong committed and the remedy.[14] See, *e.g.*, 49 U.S.C. 11705(b)(3) (a common carrier is liable for "damages" resulting from imposition of rates for transportation or service found to be in violation of the Act); 49 U.S.C. 10707(d)(1) (reparations only for amount of rate found to be unreasonable). Thus, when carrier efficiency is a consideration in a rate reasonableness case, complainants must establish a relationship between the harm inflicted because of the inefficiency and the remedy (resulting rate level). In judging the reasonableness of a rate, the states are required to apply all standards and procedures in accordance with the provisions of the Act, including general principles underlying the Act.

For example, if it is demonstrated that a carrier is carrying certain traffic in another part of its system at below directly variable cost and, as a consequence, is sustaining a loss on such traffic amounting to $1 million over a given period, the remedy of lowering the rate to the jurisdictional threshold based on the existence of the "inefficiency" would bear no relation to the "wrong" if so lowering the rate would deprive the carrier of $2 million over that same period. Such a remedy would be punitive and would drive the carrier farther into revenue inadequacy, in violation of the Congressional mandate.

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[14] We emphasize that to demonstrate inefficiency shippers must follow the evidentiary standards set out in *Long-Cannon*, which require some specificity in evidence.

D. *The States Must Apply The Federal Standards*

There can be no doubt that the problem of inadequate railroad earnings that Congress sought to remedy in the Staggers Act was not solely attributable to restrictive ICC regulation of interstate rates. For over a century, the various states had exercised independent jurisdiction over *intrastate* rates charged by rail carriers. Regulatory lag at the state level and the application of state rate-making standards differing from federal standards resulted in even lower revenues on intrastate rail transportation than those generated by interstate transportation. *See Indianapolis Power & Light Co.* v. *ICC*, 687 F.2d 1098, 1100 (7th Cir. 1982).

The effect of intrastate traffic on overall railroad revenues is substantial. In 1979, intrastate traffic accounted for $2.2 billion in total railroad freight revenues (or 9 percent of such revenues). See C. Rockey, *A Case For Uniform Regulation of Railroad Freight Rates*, 48 ICC Pract. J. 45 (1980).

The establishment of maximum rates on intrastate traffic by state regulatory bodies resulted in lower rates and revenues on intrastate traffic. Thus, in 1980 the House Committee found that (*House Report* at 61):

> [T]he disparate treatment of intrastate and interstate traffic is reflected in the difference between average revenue to variable cost ratios for each type of traffic: 1.20 for intrastate traffic and 1.36 for interstate traffic in 1977. If the intrastate ratio had been equal to the interstate ratio that year, the railroads would have earned $400 million in additional revenues.

In enacting the Staggers Act, Congress recognized that its objective of restoring the nation's railroads to financial health would be significantly undermined if the inconsistent rate standards were to continue to prevail in the area of intrastate rates. See *Indianapolis Power & Light*

Co., supra, 687 F.2d at 1100. Accordingly, Congress in Section 214 of the Staggers Act placed limits on the states' authority to regulate intrastate rates in the future. All state jurisdiction over general rate increases, inflation-based rate increases, and fuel surcharges was expressly preempted. As to other types of intrastate rate adjustments, the statute provided that a state will be permitted to continue to regulate those rates in the future only if it acts exclusively in accordance with the provisions of the Interstate Commerce Act. 49 U.S.C. 11501 (b) (1).

The Conference Report on the Staggers Act describes the unambiguous purpose underlying Section 214:

> The conferees' intent is to insure that the price and service flexibility and revenue adequacy goals of the Act are not undermined by state regulation of rates, practices, etc., which are not in accordance with these goals. Accordingly, the Act preempts state authority over rail rates, classifications, rules and practices.

H.R. Rep. No. 1430, 96th Cong., 2 Sess. 106 (1980).

II. *The State's Decision Is Inconsistent With The Federal Standards*

A. *Erroneous Consideration Of Revenue Adequacy*

In a complaint against an established rate (as was the case here), the complainant has the burden of proof to show by convincing evidence that the assailed rate is *unreasonable,* because the carrier's published rate is presumed to be reasonable. 49 U.S.C. 10701a(a). As we have shown, the federal standard that governs this case requires a careful balancing of the revenue adequacy and efficiency considerations. Nevertheless, despite the very forceful Congressional mandate that carriers be allowed to earn adequate revenues, the state agency here found that a showing of inefficiency automatically makes any

rate above the jurisdictional threshold unreasonable. Thus, in Indiana Finding No. 55 (emphasis added), the state held: "Although the burden of proving that the assailed rate is unreasonable is upon PSI, once it has come forward with evidence showing that the management of L&N is not 'honest, economical and efficient' the burden of rebutting such allegation in order to demonstrate entitlement to differential pricing above the Staggers mandate of [the jurisdictional threhold] shifts to L&N." This analytical framework directly contravenes the governing federal standard by subordinating revenue adequacy to efficiency, and by setting up the jurisdictional threshold as a standard of maximum reasonableness. The state's analytical framework especially conflicts with the statute because it would apply to every L&N rate. (See Indiana Finding No. 66). Thus, because the "inefficiency" finding extends to L&N's entire system, rates on all of L&N's market dominant traffic could be held to the threshold. The state never explained how forcing L&N to set all of its rates on market dominant traffic at the jurisdictional threshold would permit L&N to achieve revenue adequacy when L&N is free to set its rates at that level without the state's permission. While carrier efficiency is clearly one factor that the trier of fact must consider in determining the reasonableness of an assailed rate, a finding of some carrier inefficiency is certainly no absolute bar to a railroad pricing any given traffic above the jurisdictional threshold. The state's mechanistic and absolute rule ignors entirely the practical problems inherent in balancing the two important statutory goals.

The state claims (Indiana Finding No. 69) that by holding L&N's rate to the jurisdictional threshold it has given L&N the benefit of differential pricing because it has allowed a rate that exceeds fully allocated costs. This, in the state's view, constitutes compliance with the Staggers Act's requirement that railroads be permitted to achieve revenue adequacy through differential pricing.

We find this reasoning to be nothing more than a superficial bow to the Staggers Act. By law, railroads are entitled to charge rates at the jurisdictional threshold. Thus, the fact that a rate at that level contains some differential above full cost is entirely irrelevant to the issue now before us, which is whether the railroad should be permitted to have a rate above the threshold. Under the state's reasoning, there would be little need for regulation because most rates at the threshold would probably cover full costs and more. There would have been no need for the numerous other rate related statutory changes in the Staggers Act if Congress believed that setting rates at the threshold would produce revenue adequacy. The only reason the state has provided for holding this rate to the threshold is that it is required when there is a showing of "inefficiency." But, as we discussed above, that reason is directly contrary to the governing standards. In the absence of any other rationale for holding L&N's rate to the threshold, we must conclude that the state has simply presumed any rate above that level to be unreasonable. That, however, is directly contrary to the Staggers Act. 49 U.S..C 10709(d)(4).[15]

The state agency purported to consider the carrier's need to achieve revenue adequacy by allowing some measure of differential pricing, but only up to the jurisdictional threshold. We are convinced, however, that by its approach the state agency in fact failed to consider genuinely L&N's revenue inadequacy when it prescribed the rate at the jurisdictional threshold. If a carrier has

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[15] We note that the state found (Indiana Finding No. 68) that the "just and proper rate" should "not exceed the fully allocated cost of service." We specifically rejected a maximum rate policy based solely on a strict cost-based approach in December, 1981 (some nine months before the state decision in this case) in an interim decision in Ex Parte No. 347 (Sub-No. 1). The state's subscribing to that rejected methodology is clearly contrary to governing federal standards which set rate thresholds at levels higher than fully allocated costs.

not achieved revenue adequacy, this Commission (or a state authority) is required under Section 10701a(b)(3) to ensure that the rate established in a rate reasonableness proceeding makes a meaningful contribution to the revenue adequacy goal. In fact, Indiana concluded that the "proper" rate would not exceed fully allocated costs (Indiana Finding No. 68). It raised the rate to the lowest jurisdictionally possible level, ostensibly giving effect to the revenue adequacy goal. Its admitted limited use of revenue adequacy (Indiana Finding No. 69) amounts to little or no consideration of the revenue need concept because Indiana could have prescribed no rate below the jurisdictional threshold even if revenue adequacy were nowhere mentioned in the law.

The fundamental inconsistency between the state's decision and federal standards is clearly illustrated by the fact that the rate prescribed in this proceeding is *lower* than the rate the state prescribed for the same movement in 1980.[16] By order entered September 12, 1980 in Docket No. 35884, the state agency set a rate of 69 cents per net ton, subject to applicable increases. That rate had been in effect since June 22, 1979. We find it inexplicable that the state agency can be said to have given any real consideration to L&N's revenue inadequacy when, following enactment of the Staggers Act, it has

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[16] As explained more fully in the state agency's decision (Indiana Finding No. 5) and pleadings on petition here, the rate history is complex. Following the state agency's September 12, 1980 decision, prescribing a rate of 69 cents per net ton on this traffic, L&N legally applied several general and selective increases to bring the rate up to $1.03 per net ton as of October 1, 1981. The application of the rates themselves, however, were subject to various stipulations and agreements not to collect various portions of the rate subject to the outcome of certain litigation. The agreements left the rate at 94 cents as of October 1, 1981. In *Indianapolis Power & Light Co.* v. *ICC*, 687 F.2d 1098 (7th Cir. 1982), L&N prevailed in the subject litigation. Therefore, increases approved by this Commission subsequent to the state agency's decision in No. 35884 would bring the rate to $1.11 per net ton as of September 1, 1982.

chosen to reduce a rate that it previously has found reasonable (at a level that reflects subsequent authorized increases). The state agency's order in the instant case does not explain the reason for this drastic rollback below the approved rate level for past years, and is inconsistent with the clearly stated policy of the Staggers Act.

Standing alone, the state's erroneous conclusion that the efficiency factors in the statute automatically force the state commission to hold L&N's rates to the jurisdictional threshold compels reversal of the state's decision.

B. *Improper Application of Carrier Efficiency Factors*

Even if the state agency's approach to determining the reasonableness of the assailed rate were valid, we would still have to overturn the state's decision because its findings (Indiana Findings No. 63 and 64) that L&N is "inefficient" reflect standards that are contrary to federal standards and are unsupported by the record.

The state agency concluded that complainants had met their burden of proving the "overall inefficiency" of L&N on the basis of evidence, submitted by two witnesses (Indiana Findings Nos. 56 and 57).[17] One witness suggested that inefficient management at L&N is responsible for the profit margin of L&N being lower than that of its corporate parent, CSX Corporation. Specifically, the witness testified that although the ratio of sales to assets and the ratio of assets to equity are very similar for CSX and L&N, the ratio of net revenue to sales (6 percent for L&N, 10 percent for CSX) differed. Although the witness very generally stated that in his opinion the reason the profit margins differed was because L&N is not as efficiently managed as other parts of the CSX system, he admitted that there are other possible reasons for the differ-

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[17] Indiana Finding No. 66: "PSI established the overall inefficiency of L&N system-wide, establishing its inferior profit margin and its inferior utilization of locomotives, cars, labor and track."

ences, *e.g.*, differences in types of operating characteristics for the various CSX subsidiaries. The witness admitted that he did not attempt to determine which reason or reasons "actually cause said difference in the profit margin." Transcript p. 65.

The second witness tried to show that the Family Lines Rail System (of which L&N is a part) is inefficient by comparing selected statistical measures of its operating efficiency with those of one, and only one, other railroad system—Southern Railway—which is recognized as one of best performers in the railroad industry. The statistics selected for comparison do indicate that Southern had a better operating performance in certain areas than did the Family Lines. However, the witness did not determine whether or not there are differing characteristics which would cause inherent differences in operating performances. The witness conceded that differences in gradients could have an impact on the operating statistics and that he had not attempted to determine whether there was such a difference in gradients and, if so, the extent of the difference. Tr. pp. 273-274.

Based on this evidence the state agency concluded that complainants had met their prima facie case of showing L&N's "overall inefficiency." Accordingly, the state concluded that the burden to rebut shifted to L&N. We find that the state's conclusion on this point was wrong because complainants' evidence is so general, and admittedly incomplete. Thus it is so unconvincing that no basis for shifting the burden existed.

The state's finding amounts to nothing more than an attempt to classify entire railroads as "efficient" or "inefficient." But we specifically rejected that approach in *Long-Cannon, supra*, 365 I.C.C. at 991. No company, railroad or otherwise, is perfectly efficient and the state's approach is simplistic, at best.

First, the admission by complainants' witness that various unexplored reasons exist for the different profit mar-

gins of L&N and CSX completely negates his very generalized statement that L&N is inefficiently managed. Second, even if a trier of fact were to accept that Southern is more efficient than L&N, that finding in no way is equivalent to a finding that L&N is inefficient enough to compel a downward adjustment in an otherwise reasonable rate. Efficiency in the railroad industry must be judged using generally accepted standards.[18] As a general proposition, if comparisons are to have any validity at all, they must involve at least a representative sample of various members of the railroad industry, not just one railroad which is one of the industry's best performers. If complainants' approach were a valid measure of efficiency, the management of virtually every railroad in the nation would be found inefficient (and, presumably, under the state agency's construct, not "entitled" to price its service above the jurisdictional threshold). We must conclude that complainants' evidence was so inconclusive that the burden to rebut never shifted to L&N.

Nevertheless, L&N did introduce evidence of its efforts to eliminate excess capacity and reduce operating costs, as well as evidence regarding its pricing policies. The state agency concluded, however, that the carrier had not "presented convincing evidence that its management is efficient and economical" (Indiana Finding No. 63). Even if we were to find that the state agency was correct in finding that complainants had come forth with evidence sufficient to shift the burden to the carriers, we find that L&N offset sufficiently whatever limited demonstration of general inefficiency was made by complainants.

Although complainants submitted no counter-balancing evidence to establish that L&N's pricing policies were not generally accepted in the industry as appropriate, the state agency found those policies wholly inadequate. Indiana Finding No. 58. The state pointed to failure to

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[18] See, *Coal Rate Guidelines, Nationwide, supra*, at 14.

conduct formal elasticity studies, reliance on information gleaned from shippers, and reliance on the experience and best judgment of the railroad's pricing officers. Contrary to the position taken by the state agency, we stated in *Long-Cannon, supra*, 365 I.C.C. at 992, that optimum pricing of marginal traffic does not necessarily require elasticity studies:

> In our opinion, railroad management is best suited, and has every incentive, to determine when formal elasticity studies are necessary. The cost of performing formal elasticity studies for all competitive traffic would be prohibitive.

We further found that pricing policies like those described by L&N conform with reasonable standards (*ibid.*):

> In more instances than not, a carrier's rate officers, through their marketing efforts, negotiations with shippers, and knowledge of the presence and level of competition, are far more capable than we of constructing an optimal rate structure, using elasticity studies where needed.

A systematic or mathematical formula for allocating revenue shortfall is probably impossible and clearly is inconsistent with the market-based pricing the Staggers Act directs.

With respect to L&N's evidence regarding its efforts to eliminate excess capacity and reduce operating costs, the state agency found that, while those efforts were commendable, "they are projects of limited scope which can therefore only constitute a very limited demonstration of proper management efforts." Indiana Finding No. 59. The state agency apparently relied upon the testimony of complainants' witness Corbin who claimed that such efforts did not go far enough. Complainants' Exhibit 6, pp. 39-42. Mr. Corbin did not, however, provide any sound basis for his opinion that L&N was not going far enough and fast enough in those areas, and he conceded

that railroads are not free to improve their efficiency by abandoning deficit rail lines or closing deficit producing agency stations; they must obtain authority to do so from the appropriate state or federal agency. These structural difficulties in achieving system-wide efficiency were part of the reason we rejected a suggestion in Long-Cannon that we by rule quantify system-wide revenue shortfall due to inefficiency. See *Long-Cannon, supra,* 365 I.C.C. at 992.

While in all likelihood L&N is not as efficient as it could be, it is clearly taking steps to improve its performance. Its pricing practices have not been shown to produce inequitable results, nor does complainants' evidence demonstrate specific improprieties warranting a reduction in the challenged rate.

The state also castigated L&N for having no system for allocating revenue shortfall. Indiana Finding No. 58. Again, however, in *Long-Cannon* we specifically found such systems unnecessary. 365 I.C.C. at 986, 993.

The state agency also based its finding of carrier inefficiency on L&N's failure to maintain data sufficient for it to determine how much of its traffic is non-compensatory and how much of its traffic falls below full costs. Indiana Findings Nos. 58 and 65. These conclusions are based on answers given by L&N to interrogatories submitted by complainants. Specifically, in Interrogatory No. 13, complainants asked L&N to provide data on the volume and freight charges, if any, attributable to traffic transported by L&N below variable cost and traffic transported below full cost. L&N replied that it did not have the requested information and that it would have to conduct special studies to develop it. See Opening Statement of P.E. Corbin, Complainants' Exhibit 2, p. 42.

In *Long-Cannon, supra,* 365 I.C.C. at 997, we discussed the complainant's burden of coming forward with evidence relevant to the Long-Cannon factors. We stated

that in seeking discovery relevant to those factors, the complainant must focus its request as narrowly as possible (*ibid.*):

> We will not sanction "fishing exhibitions" in which a complainant asks a carrier to reveal cost studies for all its movements. Complainants must identify particular commodities or rates or routes that it believes appropriate for Long-Cannon analysis and so focus their discovery requests.

Although the state decision was issued two weeks after *Long-Cannon*, it contains no reference to these governing federal standards. Indeed, under *Long-Cannon*, L&N would not have been required to answer many of the complainants' broadly-phrased interrogatories. Complainants offered no "particular commodities or rates or routes" that they believe appropriate for Long-Cannon analysis, although Rail Form A evidence was available to them. Indiana could have reopened the record to provide complainants further opportunity to justify their discovery requests in light of *Long-Cannon*, but it did not do so. Instead the state found that the absence of data requested provided L&N "inefficient."

Nevertheless, we find L&N's answer to interrogatory No. 13 disturbing. Interrogatory No. 13 closely resembles Document Request No. 3 in *The Dayton Power & Light Company* v. *Louisville and Nashville Railroad Company*, 366 I.C.C. 365, —— n.3. Yet in *Dayton* L&N did not argue that the requested data did not exist. Rather, L&N tacitly admitted that the data exists. It appears as though L&N was not being entirely forthright when it replied to Interrogatory No. 13 by saying it did not have the data. While not the same as a refusal to provide any timely response to a reasonable discovery request, which we found unacceptable in *Long-Cannon*, 365 I.C.C. at 997, L&N's response here was not what we expect from railroads responding to discovery requests.

L&N's inexplicable behavior cannot and does not permit us to affirm the state's decision, however. This is a proceeding under Section 11501(c), and if we find that the standards and procedures applied by a state are inconsistent with the Act, we must determine and authorize the appropriate rate. Here, as we discussed above, the state applied standards plainly inconsistent with the Act's revenue adequacy provisions. Because that error would persist even if L&N were shown to be "inefficient" in some degree, we must reverse the state and authorize an appropriate rate.

We emphasize, however, that we are not convinced that L&N has been shown to be "inefficient" in any respect. Here, the burden of showing "efficiency" never shifted to L&N. Even if it had, L&N stated clearly that it is not carrying traffic at uncompensatory rates,[19] and we know now (from our *Dayton* proceeding) that L&N does have the cost evidence found absent here. Thus, no factual basis exists for the state's finding of an irrational pricing structure. While the carrier may not have been completely forthright concerning the answer it gave to Interrogatory No. 13, the fact remains that the state had no basis in the record for assuming that L&N is carrying traffic at uncompensatory rates. The state's findings on efficiency must fail because our decisions, and thus

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[19] L&N's witness, Mr. McCormack, on cross-examination denied that L&N in fact carried any traffic below variable costs (Transcript, p. 111):

> Judge York: You're not saying, are you, that the railroad carries any traffic that makes them less money than the cost to run the traffic?
>
> Witness McCormack: Not from a directly variable cost standpoint.
>
> Judge York: Well, putting aside semantics or whatever, does the railroad carry traffic that costs them more to run than they make?
>
> Witness McCormack: Not to my knowledge, no.

the state's as well, must be based on substantial evidence of record and not assumptions or presumptions based on failed attempts to shift the burden of producing evidence.

Finally, the state can reopen this proceeding to allow the shipper to make the showing required by Long-Cannon. L&N could then be required to respond to reasonable, particularized discovery requests. Thus, L&N's apparent lack of cooperation on discovery here will not deny the shippers a remedy against any unreasonableness in the rate, if such unreasonableness is later found in accordance with the standards and procedures of the Interstate Commerce Act.

The state acted as though we had not decided *Long-Cannon*, and effectively imposed on L&N the very requirements we rejected in that case. The state's approach assumes that L&N is in fact carrying traffic at rates below going concern value, because only the strong possibility that such rates exist would justify punishing L&N for not having information to prove it has no such rates. But again, we have specifically rejected that assumption. See *Long-Cannon, supra*, 365 I.C.C. at 990, 991, 992; Ex Parte No. 347 (Sub-No. 1) (dec. served Feb. 24, 1983 at p. 14). Given the timing of *Long-Cannon* and this decision, and their conflicting nature, the state could have either reopened the matter so that the complainants could comply with the requirements of *Long-Cannon*, or ruled against complainant on the efficiency issues.[20]

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[20] We recognize that in *Dayton Power & Light, supra*, decided after *Long-Cannon* was issued, we did not require a complainant who had not met the *Long-Cannon* requirements to resubmit its discovery request after making the necessary specific showing of inefficiency. The circumstances there were unique, however, and we stressed that our decision to waive the *Long-Cannon* requirements for specific showings of inefficiency was similarly unique. Specifically, the unique factors motivating the exception in Dayton were: (1) the fact that the discovery requests had been pending

We find that the state agency's findings regarding L&N's management "inefficiency" are not supported by the evidence. Complainants failed to carry their burden of proof, and the very inconclusive evidence with which they did come forward was sufficiently rebutted by L&N.

C. *Improper Remedy*

As we discussed supra, the Act requires a reasonable relationship between the wrong committed and the remedy. Here, as applied by the state, a reasonable relationship between the alleged wrong (carrier inefficiency) and the remedy (the rate reduction) is lacking. There is no evidence to measure the cost of the alleged inefficiency. Thus, the effect of any inefficiency, if proven, could have been very minor in comparison to the rate reduction which was ordered. We find that the state erred in ordering a specific rate reduction when it had no estimate of the dollar value of the alleged inefficiency.

III. *Determination of Appropriate Rate*

Section 11501(c) requires us to "determine and authorize" the railroad to "establish the appropriate rate" if the standards applied by the state are inconsistent with the federal standards. "Final action" must be taken within 30 days from the date we receive the petition for review of the state decision. We cannot remand the case to the state authority but must establish an appro-

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for well over a year by the time we resolved them in *Dayton*; (2) the fact that the discovery requests were relatively narrow; (3) the fact that the information requested was at least in part sought merely to confirm the validity of evidence already in the shipper's possession; and (4) the fact that the shipper making the discovery request had no advance notice of the *Long-Cannon* requirements.

Given those unique factors, we concluded that it would be inequitable to require the complainant to resubmit its discovery requests after making a showing of specific inefficiency. Those factors do not exist here, and the state could have reopened its case to conform to the federal standards.

priate rate in the same decision within the 30-day time period. In this case, we determine that L&N's existing rate is appropriate and authorize the carrier to continue charging it.

In our prior decision, we analyzed the evidence of the costs to operate over the subject line and found that the variable cost is 46.5 cents per ton and the fully allocated cost is 62.1 cents per ton. We reaffirm our cost findings, as contained in our prior decision's Appendix. Based on those costs, we found that the revenue to variable cost ratio of the assailed 94-cent per ton rate (October 1, 1981 level) is 202 percent. We also reaffirm our finding in the prior decision that that level is comparable to other levels we have found to be reasonable, especially where considerations of revenue adequacy are significant. (See cases cited in our prior decision, p. 6).

We wish to emphasize the following points, however. First, complainants bear the burden of showing that an existing rate is unreasonable. Absent such a showing, the railroad's rate stands. Here, the state decision holding down L&N's rate rests upon the "inefficiency" finding we have found inconsistent with federal standards and factually unsupported. Nothing else in the state's decision supports a finding of unreasonableness.

Second, L&N's rate is well below that of other intra- and interstate unit-train coal rates in the area. See Witness Strouse, L&N, Ex. 8. Given the strong Congressional policy embodied in Section 11501 against unfounded disparities between intra- and interstate rates on similar movements, we find no basis here for holding as unreasonable rates that do not even fully close the gap between intra- and interstate rates.

Third, we emphasize that we are not setting a maximum reasonable rate, but are merely finding L&N's rate to be reasonable. In short, absent any showing that L&N's rate is unusually high, and given the defective basis of the state's decision, we can find no basis for lowering L&N's rate.

L&N's PETITION FOR CLARIFICATION

Consistent with the provisions of 49 U.S.C. 11501(c), and our prior decision in No. 38809, *Louisville and Nashville—Petition to Review Decision of Kentucky Railroad Commission* (not printed), served April 15, 1982, we will grant L&N's requested relief that we "determine and authorize the carrier to establish the appropriate rate". In using that language in the statute, Congress clearly evinced an intention that rates set under the mechanism of section 11501(c) not be considered prescribed within the meaning of *Arizona Grocery Co.* v. *Atchison, T. & S.F. Ry.*, 284 U.S. 370 (1932).

INTRASTATE CERTIFICATION ISSUE

Finally, because of our findings on the merits, we need not reach L&N's request that we revoke Indiana's provisional certification to regulate intrastate rates. In this regard, however, we note that the relief sought is not authorized by section 11501(c) but rather is a collateral attack on our findings in Ex Parte No. 388, *State Intrastate Rail Rate Authority* (not printed), served February 8, 1982, and subsequent decisions thereunder. Where a state's standards and procedures are discordant with the preemptive federal requirements, we have ample remedial authority under section 11501(c). See No. 38905, *Burlington Northern Railroad Company* v. *Public Utilities Commission of the State of Colorado* (not printed), served October 25, 1982. We have consistently rejected challenges to the provisional certification process raised outside the context of Ex Parte No. 388. See, e.g., No. 39020, *Petition for Review of a Decision of the Public Service Commission of Indiana* (not printed), served January 21, 1983. Consequently, we take this opportunity to put railroads on notice that future attempts to question the certification process itself in proceedings under section 11501(c) will be summarily rejected.

It is ordered:

1. Upon reconsideration on the present record, L&N's petition for review is granted to the extent set forth in this decision. We determine that the appropriate rate is 94 cents per net ton at the October 1, 1981 level, subject to intervening increases.

2. L&N's petition for clarification is granted.

3. This decision is effective on the date of service.

4. This proceeding is discontinued.

By the Commission, Chairman Taylor, Vice Chairman Sterrett, Commissioners Andre and Gradison. Commissioner Andre concurred with a separate expression. Chairman Taylor dissented with a separate expression.

AGATHA L. MERGENOVICH
Secretary

[SEAL]

COMMISSIONER ANDRE, concurring:

I fully agree with the majority's position that the state commission had no evidence before it that inefficiency or cross-subsidization actually existed, much less that it was large enough to justify the revenue reduction that was ordered. The evidence before the state commission in no way justified the remedy that it ordered.

Let us assume, however, that the evidence of record had demonstrated the existence of avoidable loss traffic *and* had quantified the extent of the loss. I submit that, even if this had been shown, the Act does not necessarily entitle a shipper to have its rates reduced to the jurisdictional threshold. We would be totally ignoring the revenue adequacy provisions of the Act if we were to assume that the mere existence of loss traffic (or some other inefficiency) could automatically justify pushing a revenue inadequate carrier *further* into revenue inadequacy by

reduction of rates on profitable traffic. Before rate reductions are ordered for a revenue inadequate railroad as a response to inefficiency, the following steps should be taken at the very least:

(1) First, the revenue inadequate railroad should be given an opportunity to submit a plan for the elimination of the loss traffic or inefficiency. (This was not done here.) In order to satisfy the statutory concern for efficient operations, revenue reductions for profitable traffic may be allowed if the railroad refuses to take feasible and lawful steps to eliminate the inefficiency.

(2) The loss from inefficient operations (after verification and quantification) should first be applied as an offset to the carrier's total revenue inadequacy shortfall before it is applied to justify revenue reductions. (This was not done here.) Revenue reductions should be required only to the extent that the dollar amount of the inefficiency exceeds the revenue inadequacy shortfall. If the inefficiency is less than the extra revenues that are entitled to be earned to attain revenue adequacy, we would be ignoring the revenue adequacy provisions of the Act if we were to require an immediate revenue reduction equal to the entire dollar amount of the inefficiency.

(3) Finally, revenue reductions should not be ordered as a response to inefficiency *unless* the regulatory body first makes a reasoned determination of which traffic should benefit from the revenue reduction. The entire amount of the rate reductions should not necessarily be absorbed by one particular shipper since other shippers may also be disadvantaged by the inefficiency. Here, the state commission simply assumed that the complainant in this docket should be the main beneficiary of its response to the alleged inefficiency of the railroad, even though the alleged inefficiency was not shown to be peculiar to the operation serving the complainant.

CHAIRMAN TAYLOR, dissenting:

After a careful review of the Commission's earlier decision, the pleadings, and the staff's recommendations, I am convinced that the decision of the Indiana Commission was incorrectly overturned. While I agree with the majority that this case presents difficult issues, many of which are still unresolved, I believe that the Indiana PSC, given the facts before it and the lack of federal standards, had a rational basis to rule as it did. I would not disturb that decision except for correcting certain of the state agency's findings regarding variable costs attributable to the service in question.

In this case, the Indiana Commission issued a very detailed decision. It set forth the factual determinations underlying its ultimate conclusion in 71 separate findings, relying upon our standards whenever available, with citations, for example, to the market dominance guidelines established in *Complaints Filed,—229—Staggers Rail Act of 1980*, 365 I.C.C. 507 (1982) and *Market Dominance Determinations*, 365 I.C.C. 118 (1981).[1]

As pointed out by the majority, the statutory provisions require a consideration and balancing of "revenue adequacy" and "management efficiency" factors, including the closely related *Long-Cannon* factors. But, while our views on revenue adequacy have been clearly enunciated in numerous cases, this Commission has yet to give concrete meaning to the *Long-Cannon* factors or to establish standards for "economical and efficiency management". Thus, there are at present no clearly identifiable

[1] The Indiana Commission's inefficiency finding ultimately rests upon the state agency's conclusion that, based on the evidence presented, L&N had no quantifiable marketing tools and was using inefficient pricing practices. These conclusions are supported by the record. In this regard, I would also note that L&N's assertion here that the data did not exist cannot be ignored because of contrary representations in a proceeding involving a different state, behavior which the majority correctly terms "inexplicable."

federal standards to guide the states in applying these factors in particular cases, and this Commission is simply substituting its judgment for that of the Indiana PSC. Were this matter initially before us, I might well reach a different conclusion than the state agency. But that is not the statutory scheme. Absent inconsistency with federal standards and procedures, the decision by the Indiana Commission must stand.

The same rationale applies to the remedy selected by the Indiana PSC. As yet, there exists no federal standard by which to judge the Indiana Commission's setting of the appropriate rate once it determined L&N's rate to be unreasonable. Given this fact, I would not disturb the state agency's remedy, except to adjust the actual rate based on our finding that the variable cost figure was incorrectly derived. The administrative process, after all, is not modeled on "The Price is Right".[2] The Indiana Commission should not be required to guess—and guess again—as to the appropriate remedy, absent enunciation by this Commission of a federal standard.

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[2] See *Trans Alaska Pipeline Rate Cases*, 436 U.S. 631, 653 (1978).

APPENDIX F

Service Date—Nov. 24, 1982

INTERSTATE COMMERCE COMMISSION

DECISION

No. 38946

PETITION OF LOUISVILLE AND NASHVILLE RAILROAD COMPANY FOR REVIEW OF A DECISION OF THE PUBLIC SERVICE COMMISSION OF INDIANA PURSUANT TO 49 U.S.C. 11501

Decided: November 22, 1982

By petition filed October 25, 1982, the Louisville and Nashville Railroad Company (L&N) seeks review pursuant to 49 U.S.C. 11501(c) of a decision of the Public Service Commission of Indiana (PSCI) which prescribed the maximum reasonable rate for certain intrastate coal movements.[1] L&N requests relief on the basis that the PSCI failed to apply standards and procedures consistent with the Interstate Commerce Act (Act). Accordingly, L&N requests that we find that PSCI's decision exceeded its jurisdiction and is void *ab initio*, that we establish a rate of $1.11 per net ton as the appropriate rate for the transportation in issue, and that we revoke the provisional certification of PSCI to exercise jurisdiction over intrastate rail transportation. A reply was filed by the Public Service Company of Indiana, Inc. (PSI).

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[1] (PSCI) Cause No. 36431, approved September 17, 1982.

BACKGROUND

Facts. At issue are the rates for the movement of bituminous coal, in unit trains, from Universal Mine at Clinton, IN, to PSI's electric generating station at Cayuga, IN. PSI's Cayuga station is fueled exclusively with coal provided pursuant to a long-term contract with Peabody Coal Company from its Universal Mine. The annual volume of coal shipped under this contract amounts approximately to 2.5 million tons per year. PSI provides the cars for these shipments which are handled on a round-trip basis over the 26.43 miles between Universal Mine and the Cayuga generating station. L&N engines used in this service are also regularly shared with certain unit train coal movements provided by L&N for Indiana & Michigan Electric Company.

On March 27, 1981, PSI and Peabody Coal Company (complainants) filed a complaint requesting that the PSCI investigate the reasonableness of the rate for this transportation. The assailed rates are set forth in Freight Tariff LN 4278 and supplements thereto.[2] Following evidentiary submissions by the parties and oral hearings, the PSCI found that: (1) L&N had market dominance over the involved traffic; (2) the applicable rate at the October 1, 1981, level of 94 cents per net

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[2] As explained more fully in the PSCI decision, and the pleadings on petition here, the rate history is fairly complex. The application of the rates themselves are subject to various stipulations and agreements not to collect various portions of the rate subject to the outcome of various litigation. See, e.g., *Indianapolis Power & Light Company* v. *ICC*, No. 81-1916 (7th Cir. U.S.C.A.), decided September 3, 1982, and (PSCI) Cause No. 36549, stipulation of August 12, 1981. For purposes here, in (PSCI) Cause No. 35884, decided September 12, 1980, PSCI prescribed a rate of 69 cents per net ton on this traffic. Subsequent increases would have brought the applicable rate to $1.03 per net ton as of October 1, 1981. However, the agreements discussed above left the rate at 94 cents as of that date. Subsequent increases, if totally applied, would bring the rate to $1.11 per net ton as of September 1, 1982.

ton was unreasonable; and (3) the maximum reasonable rate at the October 1, 1981, level, subject to the intervening increases, was 65 cents per net ton (165 percent of variable costs).

Petition for review. L&N argues that PSCI failed to act in accordance with Federal standards in the following respects: (1) in not applying ICC guidelines with respect to establishing maximum reasonable rates; (2) in ignoring L&N's rate comparison evidence; (3) in finding that L&N's management is not efficient and economical; (4) in rejecting certain of L&N's cost adjustments; and (5) in failing to explain why the maximum reasonable rate is now lower than it was two years ago.

DISCUSSION AND CONCLUSIONS

Under 49 U.S.C. 11501(c), a rail carrier may seek Commission review of a decision made by a State authority in an administrative proceeding in which the lawfulness of an intrastate rate is determined. The grounds for review are that the standards and procedures applied by the State were not in accordance with Federal law. After reviewing the record, we conclude that PSCI's decision is inconsistent with Federal standards and procedures in certain critical respects.

I. *Market Dominance and Costs*

The PSCI properly set out as guidelines our recent standards regarding qualitative and quantitative market dominance in *Complaints Filed—§ 229—Staggers Rail Act of 1980*, 365 I.C.C. 507 (1982), and *Market Dominance Determinations*, 365 I.C.C. 118 (1981). Using these standards, the parties eventually stipulated that L&N had market dominance over the involved traffic. Through an independent review of the cost evidence of record, we were able to corroborate that the PSCI's overall development of variable costs was consistent with our evidentiary guidelines and was adequate in determining

that the challenged 94-cent rate exceeded the jurisdictional threshold.

In its decision, PSCI concluded that variable costs were 39.1 cents per net ton and prescribed a rate based on 165 percent of those variable costs, the minimum, jurisdictionally possible, rate. However, as explained in the Appendix, we conclude that certain adjustments should have been made to those costs which would in fact raise the variable cost level to 46.5 cents per net ton. Accordingly, PSCI's prescription of a rate of 65 cents per net ton results in a revenue to variable cost ratio of approximately 140 percent which is below the Federal jurisdictional standards in effect on October 1, 1981 of 165% (now 170% as of October 1, 1982).

II. *Revenue Adequacy*

Even assuming, arguably, that the Commission could adjust the rate to be consistent with the PSCI prescription of 165 percent of variable costs (1.65 x 46.5 cents or 77 cents per net ton), we must conclude that, in this case, PSCI's prescription at the jurisdictional level was not consistent with Federal standards of revenue adequacy.

One of the primary goals of the Staggers Rail Act of 1980 is promotion of railroad revenue adequacy so that the railroads can attract and retain capital in amounts sufficient to provide a sound national transportation system. 49 U.S.C. 10101a(3) and 10701a(a)(3). This is an unequivocal Congressional mandate. In our latest revenue adequacy determination, we noted that petitioner's most recent figures for return on investment (7.04 percent) fell far short when compared to our determination of the current cost of capital (16.5 percent), Ex Parte No. 439, *Railroad Revenue Adequacy—1981 Determination* (not printed), served November 18, 1982.

In No. 38793, *Petition for Review of a Decision of the Public Service Commission of West Virginia Pursuant to*

49 U.S.C. 11501 (not printed), served March 18, 1982, the Commission found that a comprehensive explanation and rationale was required for a State agency attempting to set rail rates at or near jurisdictional threshold levels, especially for revenue inadequate carriers. PSCI correctly found that due to L&N's revenue inadequacy it is entitled to the benefit of differential pricing on captive traffic (pricing above full costs) to reach the revenue adequacy goal. PSCI then went on to consider the complainants' allegations of L&N's lack of efficiency in determining the degree of differential pricing which this traffic should bear.[3]

PSI attempted to obtain information regarding the Long-Cannon factors through the use of interrogatories, but the L&N claimed that it did not have the data requested. Subsequently, PSI attempted to establish L&N's inefficiency through the cross-examination of L&N's pricing witness and by producing witnesses who compared L&N's profitability to its parent corporation, and compared the operating performance of the Family Lines System (of which L&N is a part) to a competitor, the Southern Railway Company. The PSCI found that PSI had submitted enough relevant evidence on efficiency factors to require L&N to rebut, and that L&N's rebuttal evidence constituted only "a very limited demonstration of proper management efforts." (Finding No. 59) Accordingly, PSCI found that L&N had "not presented convincing evidence that its management is efficient and economical." (Finding No. 63) Because of this finding,

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[3] Standards for the handling of evidence regarding rail efficiency in complaint proceedings were just recently issued in No. 38754, *Arkansas Power & Light Company, et al.-Petition to Institute Rulemaking Proceeding-Implementation of Long-Cannon Amendment to the Staggers Rail Act* (*Long-Cannon*) (not printed), served September 3, 1982, in which we issued a policy statement regarding the so-called "Long-Cannon" factors set forth at 49 U.S.C. 10707a(e)(2)(B) and (C). See also 49 U.S.C. 10704(a)(2), 49 U.S.C. 10707a(e)(2)(C) and *Long-Cannon, supra.*

PSCI also found that L&N was not entitled to use differential pricing to raise the rate on this coal movement above the then applicable jurisdictional threshold of 165 percent. (Finding Nos. 55 and 69) The PSCI rationalized that it did provide for some degree of differential pricing, since it prescribed a rate in excess of the fully allocated cost of the movement, including the current cost of capital.

In finding L&N inefficiently managed, the PSCI criticized L&N's pricing policy as one based on "the arbitrary 'judgment' of its pricing officers on a case-by-case basis, unaided by any quantifiable sophisticated marketing tools such as demand elasticity studies." (Finding No. 67) We recently considered the "efficiency" language in 49 U.S.C. 10704(a)(2) and the connected Long-Cannon factors in *Long-Cannon, supra,* and, in denying a rulemaking request in that proceeding specifically refused to require carriers to undertake such studies. In fact, in *Long-Cannon, supra,* at page 9, we said:

> "We also disagree with petitioners' contention that optimum pricing of marginal traffic necessarily requires elasticity studies. In our opinion, railroad management is best suited, and has every incentive, to determine when formal elasticity studies are necessary. The cost of performing formal elasticity studies for all competitive traffic would be prohibitive. In more instances than not, a carrier's rate officers, through their marketing efforts, negotiations with shippers, and knowledge of the presence and level of competition, are far more capable than we of constructing an optimal rate structure, using elasticity studies where needed."

Accordingly, the PSCIs reliance upon failure to employ these tools in finding L&N to be inefficient was improper in and of itself, and because it cut short any thought of permitting L&N to raise its rates on this movement above the jurisdictional threshold. The concept of revenue ade-

quacy is too important for such a consideration to be dismissed this quickly.

Although PSCI ostensibly considered the L&N's need to achieve revenue adequacy in allowing some measure of differential pricing, it actually gave only lip service to the goal of revenue adequacy. In fact, PSCI concluded that the "proper" rate would not exceed fully allocated costs. (Finding No. 68) Because PSCI set the rate at the lowest, jurisdictionally possible, level, it is not clear to us how, if at all, the concept of revenue adequacy was considered.

In using the questionable finding of inefficient management [4] to avoid genuine consideration of revenue adequacy, PSCI violated one of the most important Federal standards—one that permeates the present statutory scheme of railroad rate regulation. We conclude that the PSCI failed to give proper consideration to revenue adequacy. The rate level it ultimately prescribed is an indication of this because it could have set the rate no lower if it had admittedly not considered revenue adequacy at all.

DETERMINATION OF APPROPRIATE RATE

Under 49 U.S.C. 11501(c), when we determine, as here, that the standards and procedures applied by the State authority are not in accordance with Federal law,

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[4] In addition to problems relating to evidence on "efficiency" previously cited, PSCI interpreted the Long-Cannon Amendment as creating a strict burden of proof analysis. Contrary to PSCI's approach, the statute provides simply that evidence of inefficiency is to be a factor in analyzing the reasonableness of rates. The statute, furthermore, addresses issues from a much more technical perspective than PSI employed and PSCI found convincing. Consistent with our decision in *Long-Cannon, supra,* we do not believe that PSI tendered sufficient, specific evidence of mismanagement and other Long-Cannon criteria to warrant denying a revenue inadequate carrier the opportunity to become profitable.

we must determine and authorize the carrier to establish the appropriate rate. By statute we must take final action within 30 days after receipt of the underlying petition for review. PSCI held a full hearing to establish the appropriate rate and we have reviewed the record in its entirety. Additionally, we note that, at the October 1, 1981, rate level of 94 cents per net ton, which was the applicable level under consideration by the PSCI, the revenue to variable cost ratio based upon our revised figure for variable costs is 202 percent. We have in the recent past determined rates to be reasonable where they resulted in similar or substantially higher ratios, especially where considerations of revenue adequacy are significant. See *Agrico Chemical Co.* v. *Seaboard Coast Line R. Co.*, 361 I.C.C. 333 (1979), aff'd *Agrico Chemical Co.* v. *I.C.C.*, 652 F.2d 195 (D.C. Cir. 1981), where a group rate was found to be reasonable which produced a ratio of revenue to variable cost of 228 percent. See also: No. 37014, *E. I. DuPont de Nemours & Co.* v. *St. Louis Southwestern R. Co., Et Al.* (unprinted, svd. March 30, 1979) (209%-235% of variable costs); *Nat'l Electric Manufacturers Ass'n* v. *Aberdeen & Rockfish R. Co.*, 349 I.C.C. 502, 509-10 (1974), *remanded*, 407 F. Supp. 598 (W.D. Pa. 1976), *supplemented and aff'd*, 355 I.C.C. 597 (1977) (159.6%-230.1% of *fully allocated* costs); *Trainload Rates On Radioactive Materials, Eastern Railroads*, 362 I.C.C. 756, 775 (1980), *aff'd mem.*, 646 F.2d 642 (D.C. Cir. 1981) (213.8%-225.7% of variable costs).

Here, as stated earlier, L&N realizes a return on investment substantially below that is necessary for revenue adequacy. Balancing the goals reflected in Title 49 of the United States Code, especially in section 11501 and its history, the evidence before us, and practical considerations, we determine that the appropriate rate, prescribed at the October 1, 1981 level, subject to intervening increases, is the rate of 94 cents per net ton.

Given our decision here, we need not reach the other issues raised by L&N.

This decision will not significantly affect either the quality of the human environment or conservation of energy resources.

It is ordered:

The relief sought in the petition is granted to the extent set forth in this decision. The prescribed rate is set at 94 cents per net ton at the October 1, 1981 level, subject to intervening increases.

By the Commission, Chairman Taylor, Vice Chairman Gilliam, Commissioners Sterrett, Andre, Simmons, and Gradison. Commissioner Simmons dissented with a separate expression. Chairman Taylor and Commissioner Sterrett were absent and did not participate.

AGATHA L. MERGENOVICH
Secretary

[SEAL]

Commissioner Simmons, dissenting:

In matters involving state regulation of intrastate rates, this Commission may intervene *only* if it finds that a state has violated a federal procedure or definable federal standard. Because I believe that PSCI did not violate either a federal standard or procedure, I would dismiss the appeal and affirm Indiana's decision.

The majority finds that PSCI complied with our standard and procedures up until its discussion of revenue adequacy. The majority agrees that Indiana did offer a framework for application of the revenue adequacy concept and its use in the ultimate result as we required in No. 38793, *Petition for Review of a Decision of the Public Service Commission of West Virginia*, and that it correctly found that due to L&N's revenue adequacy, the railroad is entitled to the benefit of differential pricing on captive traffic to reach the revenue adequacy goal.

According to the majority, so far so good. However, the majority asserts that PSCI's findings concerning the efficiency of L&N failed to "comply with Federal law". I fail to see such a violation. In *Long-Cannon*, supra, the Commission stated: "With respect to implementation of the closely related honest, economical, and efficient management issue, we continue to recognize the difficulty of giving effect to the requirement". From this statement and the *Long-Cannon* discussion of revenue adequacy, a State agency is supposed to ascertain our standards with regard to efficient management? Webster defines standard as "something established by authority, custom or general consent as a model or example." Standards must be clear and unambiguous. Our discussion of economical and efficient management is far from clear and unambiguous.

Even if the majority is correct, it, again, does not spell out the correct approach states should follow in considering this factor, but only says what is wrong with PSCI's approach. What is the state to do without clear guidelines?

Although the Commission may have reached different conclusions regarding the efficiency of L&N's management and the amount of differential pricing to which L&N is entitled, I do not believe PSCI violated current Federal standards, especially since our standards are far from clear and precise. Absent of violation, the Commission is substituting its judgment for that of Indiana's.

APPENDIX

After accepting a number of PSI's costing adjustments during the course of this proceeding, L&N calculates the variable cost, at the embedded debt level, for the traffic in issue to be 46.6 cents per net ton. PSI's calculation resulted in a variable cost of 39.1 cents per net ton. In its petition for review, L&N argues that the difference results from five separate cost issues which should have been resolved in its favor. Our analysis of these issues is as follows:

Cost Issues

1. *Year of Rail Form A application*

L&N—The railroad notes that the shippers declined to use unit costs updated from a 1979 application of Rail Form A, ostensibly because such costs were found unacceptable to an initial decision served June 22, 1981, in ICC Docket No. 37338, *South Carolina Public Service Authority* v. *Clinchfield Railroad Company.* L&N indicates, however, that in a decision served April 7, 1982, the Commission began to prefer 1979-basis costs over those of a previous year.

PSI—The shipper's opening and rebuttal verified statements were dated March 1 and April 30, 1982, respectively. Having used in its opening evidence costs based upon 1977 data, the final year in which railroad annual reports were filed in a format directly comparable with Rail Form A, PSI did not modify its base year in the rebuttal evidence to accord with the ICC's decision of April 7, 1982, in No. 37338, *supra.*

Conclusion—In the absence of compelling reasons for the use of costs from a prior period, the most reliable estimate of costs for the immediate future would be historical costs from the immediate past. Influences upon costs such as fluctuating maintenance are commonplace

in the railroad industry and do not justify a departure from this practice. We accept L&N's unit costs.

2. *Train supplies and expenses at origin and destination*

L&N—The railroad included terminal train supplies and expenses based upon the Burden Study factor 8.515 percent of system average. Special services at origin and destination were excluded.

PSI—The shipper contends that of the various miscellaneous components of this unit cost and the companion special services, only inspection/policing and caboose supplies "could be remotely identified with . . . PSI's unit trains." They aver that the ICC recently modified its position respecting the inclusion of such costs in the decision served July 17, 1981, in Docket No. 37450, *Central Illinois Light Company* v. *Atchison, Topeka and Santa Fe Railway Company, et al.* A portion of the decision referring to the nonapplicability of "special services" cost in connection with unit trains was cited in support.

Conclusion—Separate unit costs are developed in Rail Form A for special services and train supplies and expenses. While exclusion from unit train costs may be justified for special services, we believe the purpose of the 8.515 percent residual train supply cost applicable to volume movements of the nature herein was, and is, sound. L&N's costs are acceptable.

3. *Investment value of locomotives*

L&N—Locomotive depreciation and cost of capital were predicated upon four units per train in the GP-38-2 and GP-40-2 series for which the average ledger value was $585,022 per unit. Such locomotive usage was determined in a study of actual time tickets for September 1981.

PSI—Citing the ICC decision served December 21, 1981, in Ex Parte No. 347 (Sub-No. 1), *Coal Rate Guidelines—Nationwide*, in which PSI claims our policy to be one of assigning investment cost directly to the traffic which requires equipment acquisition, it is contended that since the instant movement began 12 years ago, the cost of locomotives of similar vintage should be used herein. For this proceeding PSI uses costs for such locomotives taken from another proceeding.

Conclusion—PSI did not challenge the validity of L&N's study, and we know of no rationale for holding that equipment acquired for specific movements cannot be replaced by modernized versions as the originl equipment ages. It would appear to be good management practice to install newly acquired locomotives in such demanding services as 100-car bulk commodity trains. To hold otherwise would discourage replacement of obsolete physical property. L&N's cost is acceptable.

4. *Fuel Cost*

L&N—On three consecutive days in September 1979 and also in January 1980, fuel was metered. Thus, average consumption per trip of 984 gallons was applied to an October 1, 1981 price of $1.17 per gallon charged by L&N's supplier, Bruno's Fuel Service. Transportation and general overheads were included.

PSI—The shipper accepts the railroad's methodology except that it applies the Rail Form A 97-percent variability ratio. PSI alleges that use of a 100-percent variability ratio cannot be acceptable unless the locomotives consumed all their fuel in handling a single traffic movement. In the instant proceeding, the locomotives also service the Indiana-Michigan movement from Terre Haute, which, coupled with empty mileage apportionable between the two movements, necessitates recognition of the constant portion of fuel expense.

Conclusion—We agree with PSI that the use made of the locomotives has not been differentiated on the record from ordinary railroad operations for which variability of the fuel expense accounts has been established at 97 percent. Accordingly, our restatement of L&N's cost per car to incorporate Rail Form A variability results would lower the figure by $.32 per car.

5. *Tonnage divisor*

L&N—The railroad contends that the total costs per car should be divided by the average car lading weight—96 tons.

PSI—PSI uses 98 tons as a divisor, which figure is based upon the minimum tariff weight for cars actually loaded at a lower weight.

Conclusion—In determining the cost per ton of handling the subject traffic, it is proper to employ as a divisor the number of tons actually moved. While the application of the tariff rate may take into account tonnage minima, ascertainment of handling cost is governed only by tons moved, whether that figure is less or greater than the minimum. Thus, L&N's methodology is acceptable.

Summary of cost analysis

Having found that L&N used acceptable procedures (with one exception) in developing its cost, it is necessary to recalculate the per car cost resulting in its figure of 46.6 cents per ton in order to reflect the 97 percent fuel expense variability. Thus, in lieu of $44.96 total variable cost per car, the fuel adjustment procedures $44.64 per car or 46.5 cents per ton. Based upon L&N's factors of 1.33449 to convert variable cost at embedded debt to fully allocated cost (ratio basis) using a 19 percent pre-tax current cost of capital, the fully allocated cost at that level is 62.1 cents per ton.

APPENDIX G

RELEVANT STATUTORY PROVISIONS

Staggers Rail Act of 1980, P.L. 96-448, 94 Stat. 1895 (October 14, 1980)

GOALS

Sec. 3. The purpose of this Act is to provide for the restoration, maintenance, and improvement of the physical facilities and financial stability of the rail system of the United States. In order to achieve this purpose, it is hereby declared that the goals of this Act are—

(1) to assist the railroads of the Nation in rehabilitating the rail system in order to meet the demands of interstate commerce and the national defense;

(2) to reform Federal regulatory policy so as to preserve a safe, adequate, economical, efficient, and financially stable rail system;

(3) to assist the rail system to remain viable in the private sector of the economy;

(4) to provide a regulatory process that balances the needs of carriers, shippers, and the public; and

(5) to assist in the rehabilitation and financing of the rail system.

Interstate Commerce Act, Subtitle IV of Title 49, United States Code, Transportation

§ 10101. Rail transportation policy

In regulating the railroad industry, it is the policy of the United States Government—

(1) to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail;

(2) to minimize the need for Federal regulatory control over the rail transportation system and to require fair and expeditious regulatory decisions when regulation is required;

(3) to promote a safe and efficient rail transportation system by allowing rail carriers to earn adequate revenues, as determined by the Interstate Commerce Commission;

(4) to ensure the development and continuation of a sound rail transportation system with effective competition among rail carriers and with other modes, to meet the needs of the public and the national defense;

(5) to foster sound economic conditions in transportation and to ensure effective competition and coordination between rail carriers and other modes;

(6) to maintain reasonable rates where there is an absence of effective competition and where rail rates provide revenues which exceed the amount necessary to maintain the rail system and to attract capital;

(7) to reduce regulatory barriers to entry into and exit from the industry;

(8) to operate transportation facilities and equipment without detriment to the public health and safety;

(9) to cooperate with the States on transportation matters to assure that intrastate regulaory jurisdiction is exercised in accordance with the standards established in this subtitle;

(10) to encourage honest and efficient management of railroads and, in particular, the elimination of noncompensatory rates for rail transportation;

(11) to require rail carriers, to the maximum extent practicable, to rely on individual rate increases,

and to limit the use of increases of general applicability;

(12) to encourage fair wages and safe and suitable working conditions in the railroad industry;

(13) to prohibit predatory pricing and practices, to avoid undue concentrations of market power and to prohibit unlawful discrimination;

(14) to ensure the availability of accurate cost information in regulatory proceedings, while minimizing the burden on rail carriers of developing and maintaining the capability of providing such information; and

(15) to encourage and promote energy conservation.

Added Pub.L. 96-448, Title I, § 101(a), Oct. 14, 1980, 84 Stat. 1897.

§ 10701a. Standards for rates for rail carriers

(b)(1) If the Commission determines, under section 10709 of this title, that a rail carrier has market dominance over the transportation to which a particular rate applies, the rate established by such carrier for such transportation must be reasonable.

(2) In any proceeding to determine the reasonableness of a rate described in paragraph (1) of this subsection—

(A) the shipper challenging such rate shall have the burden of proving that such rate is not reasonable if—

(i) such rate (I) is authorized under section 10707a of this title, and (II) results in a revenue-variable cost percentage for the transportation to which the rate applies that is less than the lesser of the percentages described in clauses

(i) and (ii) of section 10707a(e)(2)(A) of this title; or

(ii) such rate does not meet the description set forth in clause (i) of this subparagraph, but the Commission does not begin an investigation proceeding under section 10707 of this title to determine whether such rate is reasonable; and

(B) the rail carrier establishing the challenged rate shall have the burden of proving that such rate is reasonable if—

(i) such rate (I) is greater than that authorized under section 10707a of this title, or (II) results in a revenue-variable cost percentage for the transportation to which the rate applies that is equal to or greater than the lesser of the percentages described in clauses (i) and (ii) of section 10707a(e)(2)(A) of this title; and

(ii) the Commission begins an investigation proceeding under section 10707 of this title to determine whether such rate is reasonable.

(3) In determining whether a rate established by a rail carrier is reasonable for purposes of this section, the Commission shall recognize the policy of this title that rail carriers shall earn adequate revenues, as established by the Commission under section 10704(a)(2) of this title.

§ 10704(a)

(2) The Commission shall maintain and revise as necessary standards and procedures for establishing revenue levels for rail carriers providing transportation subject to its jurisdiction under that subchapter that are adequate, under honest, economical, and efficient management, to cover total operating expenses, including depreciation and obsolescence, plus a reasonable and economic

profit or return (or both) on capital employed in the business. The Commission shall make an adequate and continuing effort to assist those carriers in attaining revenue levels prescribed under this paragraph. However, a rate, classification, rule, or practice of a rail carrier may be maintained at a particular level to protect the traffic of another carrier or mode of transportation only if the Commission finds that the rate or classification, or rule or practice related to it, reduces or would reduce the going concern value of the carrier charging the rate. Revenue levels established under this paragraph should—

(A) provide a flow of net income plus depreciation adequate to support prudent capital outlays, assure the repayment of a reasonable level of debt, permit the raising of needed equity capital, and cover the effects of inflation; and

(B) attract and retain capital in amounts adequate to provide a sound transportation system in the United States.

§ 10707a(e)(2)

(C) In determining whether a rate is reasonable, the Commission shall consider, among other factors, evidence of the following:

(i) the amount of traffic which is transported at revenues which do not contribute to going concern value and efforts made to minimize such traffic;

(ii) the amount of traffic which contributes only marginally to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize the revenues from such traffic; and

(iii) the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues.

§ 10709(d)(2) and (4)

(2) In making a determination under this section, the Commission shall find that the rail carrier establishing the challenged rate does not have market dominance over the transportation to which the rate applies if such rail carrier proves that the rate charged results in a revenue-variable cost percentage for such transportation that is less than—

(A) 160 percent during the period beginning on the effective date of the Staggers Rail Act of 1980 and ending September 30, 1981;

(B) 165 percent during the period beginning October 1, 1981, and ending September 30, 1982;

(C) 170 percent during the period beginning October 1, 1982, and ending September 30, 1983;

(D) 175 percent or the cost recovery percentage, whichever is less, during the period beginning October 1, 1983, and ending September 30, 1984; and

(E) the cost recovery percentage, during each 12-month period beginning on or after October 1, 1984.

For purposes of subparagraphs (D) and (E) of this paragraph, the cost recovery percentage shall in no event be less than a revenue-variable cost percentage of 170 percent or more than a revenue-variable cost percentage of 180 percent.

(4) A finding by the Commission that rate charged by a rail carrier results in a revenue-variable cost percentage for the transportation to which the rate applies that is equal to or greater than the applicable percentage under paragraph (2) of this subsection does not establish a presumption that (A) such rail carrier has or does not have market dominance over such transportation, or (B) the proposed rate exceeds or does not exceed a reasonable maximum.

§ 11501. Interstate Commerce Commission authority over intrastate transportation

(a) The Interstate Commerce Commission shall prescribe the rate, classification, rule, or practice for transportation or service provided by a carrier subject to the jurisdiction of the Commission under subchapter IV of chapter 105 of this title when the Commission finds that a rate, classification, rule, or practice of a State causes—

(1) between persons or localities in intrastate commerce and in interstate and foreign commerce, unreasonable discrimination against those persons or localities in interstate or foreign commerce; or

(2) unreasonable discrimination against or imposes an unreasonable burden on interstate or foreign commerce.

(b) (1) A State authority may only exercise jurisdiction over intrastate transportation provided by a rail carrier providing transportation subject to the jurisdiction of the Commission under subchapter I of chapter 105 of this title if such State authority exercises such jurisdiction exclusively in accordance with the provisions of this subtitle.

(2) Within 120 days after the effective date of the Staggers Rail Act of 1980, each State authority exercising jurisdiction over intrastate rates, classifications, rules, and practices for intrastate transportation described in paragraph (1) of this subsection shall submit to the Commission the standards and procedures (including timing requirements) used by such State authority in exercising such jurisdiction.

(3) (A) Within 90 days after receipt of the intrastate regulatory rate standards and procedures of a State authority under paragraph (2) of this subsection, the Commission shall certify such State authority for purposes of this subsection if the Commission determines

that such standards and procedures are in accordance with the standards and procedures applicable to regulation of rail carriers by the Commission under this title. If the Commission determines that such standards and procedures are not in such accordance, it shall deny certification to such State authority, and such State authority may resubmit new standards and procedures to the Commission for review in accordance with this subsection.

(B) The standards and procedures existing in each State on the effective date of the Staggers Rail Act of 1980 for the exercise of jurisdiction over intrastate rail rates, classifications, rules, and practices shall be deemed to be certified by the Commission from that date until the date an initial determination is made by the Commission under subparagraph (A) of this paragraph.

(4) (A) Any State authority which is certified by the Commission under this subsection may use its standards and procedures in exercising jurisdiction over intrastate rail rates, classifications, rules, and practices during the 5-year period commencing on the date of such certification. Any State authority which is denied certification or which does not seek certification may not exercise any jurisdiction over intrastate rates, classifications, rules, and practices until it receives certification under this subsection.

(B) Any intrastate transportation provided by a rail carrier in a State which may not exercise jurisdiction over an intrastate rate, classification, rule, or practice of that carrier due to a denial of certification under this subsection shall be deemed to be transportation subject to the jurisdiction of the Commission under subchapter I of chapter 105 of this title.

(5) (A) Certification of a State authority under this subsection is valid for the 5-year period beginning on the date of such certification. Prior to the expiration of such 5-year period, the State authority shall resubmit its

intrastate regulatory standards procedures to the Commission for subsequent certification in accordance with this subsection.

(B) During any 5-year certification period, a State may not change its certified standards and procedures without notifying and receiving express approval from the Commission.

(6) Notwithstanding any other provision of this subtitle, a State authority may not exercise any jurisdiction over general rate increases under section 10706 of this title, inflation-based rate increases under section 10712 of this title, or fuel adjustment surcharges approved by the Commission.

(c) Any rail carrier providing transportation subject to the jurisdiction of the Commission under subchapter I of chapter 105 of this title may petition the Commission to review the decision of any State authority, in any administrative proceeding in which the lawfulness of an intrastate rate, classification, rule, or practice is determined, on the grounds that the standards and procedures applied by the State were not in accordance with the provisions of this subtitle. The Commission shall take final action on any such petition within 30 days after the date it is received. If the Commission determines that the standards and procedures were not in accordance with the provisions of this subtitle, its order shall determine and authorize the carrier to establish the appropriate rate, classification, rule, or practice.

(d)(1) The Commission has exclusive authority to prescribe an intrastate rate for transportation provided by a rail carrier subject to the jurisdiction of the Commission under subchapter I of chapter 105 of this title when—

(A) a rail carrier files with an appropriate State authority a change in an intrastate rate, or a change in a classification, rule, or practice that has the effect

of changing an intrastate rate, that adjusts the rate to the rate charged on similar traffic moving in interstate or foreign commerce; and

(B) the State authority does not act finally on the change by the 120th day after it was filed.

(2) When a rail carrier files an application with the Commission under this subsection, the Commission shall prescribe the intrastate rate under the standards of subsection (a) of this section and chapter 107 of this title. Notice of the application shall be served on the State authority.

(e) The Commission may take action under this section only after a full hearing. Action of the Commission under this section supersedes State law or action taken under State law in conflict with the action of the Commission.